

California State Auditor

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

Department of General Services:

*The California Multiple Award Schedules
Program Has Merit but Does Not
Ensure That the State Gets the Best
Value for Its Purchases*



August 1999
99500

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August 26, 1999

99500

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 a follow-up to issues we previously reported in October 1998, the Bureau of State Audits presents its audit report concerning the California Multiple Award Schedules (CMAS) program.

This report concludes that although the CMAS program may have reduced administrative costs and improved the flexibility of procurements of information technology, it does not ensure that purchases represent the best value. Specifically, CMAS prices are merely ceiling prices, not the best prices available. Furthermore, the Department of General Services' assertion that CMAS prices are fair and reasonable is based on several faulty assumptions, and as a result, we noted several instances in which CMAS vendors overcharged state agencies. Therefore, comparison shopping is essential to optimize the benefits of the CMAS program.

Respectfully submitted,

KURT R. SJOBERG
State Auditor

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SUMMARY

Audit Highlights . . .

Although the California Multiple Award Schedules (CMAS) program may have reduced administrative costs and improved the flexibility of procurements of information technology, it does not ensure that purchases represent the best value. Specifically:

- CMAS prices are merely ceiling prices, not the best prices available.*
 - The Department of General Services' assertion that CMAS prices are fair and reasonable is based on several faulty assumptions, resulting in higher prices than necessary.*
 - Comparison shopping is essential to optimize the benefits of the CMAS program.*
-

RESULTS IN BRIEF

The Department of General Services (department) created the California Multiple Award Schedules (CMAS) program from legislation enacted in 1993 to streamline the purchase of information technology goods and services by state agencies while preserving reasonable price protections. It was envisioned that the program would enable state agencies to purchase information technology from any prequalified vendor with assurance that they were paying fair and reasonable prices.

Although the CMAS program appears to have accomplished the goals of reducing the administrative cost of procurement, standardizing contractual provisions in state purchasing contracts, and screening out irresponsible vendors, it has not been as successful in ensuring that the State receives the best value for its purchases. CMAS prices are merely ceiling prices that a vendor is not to exceed—not the best prices available. The department does not contractually require CMAS vendors to give state agencies the lowest price they offer to comparable commercial customers, as a similar program managed by the federal government does.

Because the CMAS program was not designed to ensure that customers receive the lowest available price, we found numerous examples where vendors charged state departments more than other customers. In one case, the State paid \$15,700 for a computer component that the vendor sold to a commercial customer approximately two weeks earlier for \$13,600.

The department has not implemented our prior recommendation that it require state agencies to compare prices offered by different CMAS vendors because it believes that such “process-driven” requirements are contrary to legislative intent and best-procurement practices. It designed the CMAS program to support value-based purchasing, where buyers assess a product’s total value and not just the price, by establishing processes that it thought would result in fair and reasonable prices. But the program’s evolution and the dynamic nature of the information technology market have reduced the likelihood that state agencies using CMAS will receive fair and reasonable prices.

The department's assertion that CMAS prices are fair and reasonable is based on the assumption that prices paid for CMAS purchases match, or are less than, prices that have been competitively assessed by the federal government or other entities—typically a state or county. However, this assertion was undermined when it began allowing vendors without their own contracts to obtain CMAS agreements by simply agreeing to provide the same products and prices as the companies holding the original base contracts. This arrangement, known as “piggybacking”, permitted the department to greatly expand the number of CMAS vendors. But the prices of the piggybackers we reviewed did not always accurately mirror those of the underlying contracts, and with piggybacked contracts comprising 80 percent of the more than 2,000 CMAS contracts, we have concerns that state departments are placing imprudent reliance on CMAS prices.

The department's assertion that CMAS prices are fair and reasonable also assumes that sales representatives will offer items at or below the agreed-upon CMAS price, and that buyers will be able to verify the price. However, these assumptions are flawed. Because the bases for the department's assertions are faulty, we found several instances in which CMAS vendors overcharged state departments. For example, one vendor agreed to charge state departments prices resulting in 1 percent to 5 percent profit margins, but in fact charged the State prices resulting in profit margins as high as 25 percent.

State agencies therefore cannot effectively evaluate value-based purchases by placing CMAS orders with the first vendor they call. Like the architects of the federal program on which CMAS is partially modeled, we believe that comparison shopping and value-based procurement go hand-in-hand. State agencies that do not take advantage of CMAS's rich competitive environment through comparison shopping defeat the purpose of value-based procurement.

RECOMMENDATION

The department strongly encourages state agencies to comparison shop to optimize the benefits of the CMAS program. However, to ensure that the State receives the best value for goods and services purchased through CMAS, the department should require state agencies to determine the latest available federal program price, whenever practical, and then

comparison shop by obtaining three “value quotes” from competing CMAS vendors for all purchases with an extended price (quantity ordered multiplied by item price) of \$2,500 or more. To further ensure that CMAS purchases are value-based, state agencies should negotiate for the best value available.

AGENCY COMMENTS

The department disagrees with our recommendation that state agencies be required to comparison shop. Rather, it believes that additional auditing, training, and educational activities, as well as the development and implementation of the California Statewide Procurement Network, would address the concerns noted in our report. ■

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INTRODUCTION

BACKGROUND

Based on legislation enacted in 1993, the Department of General Services (department) created the California Multiple Award Schedules (CMAS) program in part to provide for “the expeditious and value-effective acquisition of electronic data processing goods and services to satisfy state requirements.” Value-effective or value-based acquisitions consider qualitative factors such as the quality of the product or service, reliability of delivery and implementation schedules, warranties and return policies, and vendor expertise in addition to price.

The CMAS program was intended to reduce the time and administrative expense state agencies incurred acquiring information technology goods and services under traditional procurement processes while preserving reasonable price protections. Under a traditional procurement process, an agency generally prepares a request for proposals or similar document that describes the products or services it wants to acquire, invites prospective vendors to submit written proposals that include their prices, and describes the criteria the agency will use to evaluate the proposals. After advertising its request for proposals, the agency evaluates the proposals received, selects the winning vendor, resolves any protests filed, and awards a contract. The department contends that, depending on factors such as the nature of the good or service to be acquired, the number of vendors bidding, and the number of protests filed, this process often takes from three to eight months. The CMAS program was intended to represent a more efficient and flexible alternative to this cumbersome process.

Like the federal Multiple Award Schedules program (federal program), CMAS uses multiple award schedules that represent contracts awarded to multiple vendors who agree to sell specific products and services at approved prices throughout the contract term. Agencies can therefore buy products from participating vendors without going through a bidding process; they simply choose a vendor and place an order. However, with few exceptions, vendors may only sell, and agencies may only buy, products and services specifically identified in a vendor’s CMAS

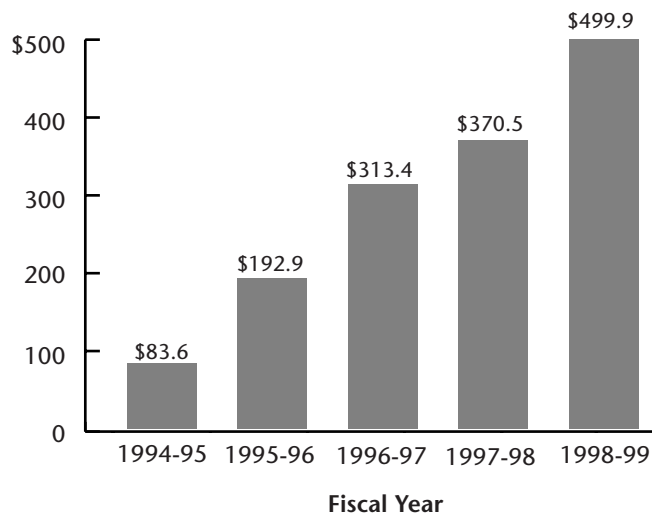
contract. For example, a vendor that is only approved to sell certain computer hardware cannot sell voice mail systems through the CMAS program. State agencies can purchase commodities such as furniture, as well as information technology, through the program. However, CMAS is primarily used for the purchase of information technology such as telecommunications and electronic data processing goods and services.

VENDORS' PARTICIPATION IN THE CMAS PROGRAM

Since its inception in 1994, the CMAS program has grown. According to the department, total purchases through the program for fiscal year 1998-99 were nearly \$500 million, a 498 percent increase from fiscal year 1994-95 purchases of \$84 million (see Figure 1). The number of vendors participating in the CMAS program is also increasing. Only 121 vendors held CMAS contracts in fiscal year 1994-95. By the end of fiscal year 1998-99, the number had grown to 1,327.

FIGURE 1

The Amount of Goods and Services Acquired Through the CMAS Program Has Steadily Increased (In Millions)



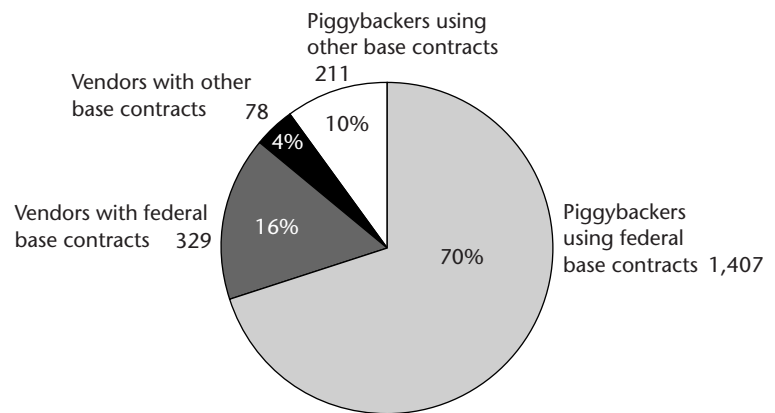
Source: Unaudited data from the Department of General Services' Purchasing Information Network.

To participate, vendors must agree to offer products and services to CMAS customers on the same terms, conditions, and prices as existing multiple award schedule contracts (base contracts). The base contract must either be awarded by the General Services Administration of the United States or competitively awarded by some other entity—typically a state or county. Although some CMAS vendors hold their own base contracts, most—known as “piggybackers”—use other vendors’ existing contracts to participate in CMAS. Piggybackers agree to provide the same products and prices as the vendors holding the base contracts.

Figure 2 shows that as of April 30, 1999, only 329 (16 percent) of the 2,025 active CMAS contracts were based on contracts vendors held with the federal government, while 1,407 (70 percent) were based on vendors piggybacking onto existing federal contracts. Only 78 CMAS contracts (4 percent) were based on contracts vendors held with other entities, and 211 (10 percent) were based on vendors piggybacking onto these contracts.

FIGURE 2

Piggybackers Held 80 Percent of Active CMAS Contracts as of April 30, 1999



Source: Unaudited data from the Department of General Services’ Purchasing Information Network.

THE DEPARTMENT’S PROCUREMENT RESPONSIBILITIES

The department charges state and local government agencies an administrative fee for use of the CMAS program. The fee is equal to 1.21 percent of the value of each CMAS order; however, orders placed with small businesses are exempt. In return for

this fee, the department oversees the CMAS program and is responsible for developing and maintaining the program's policies and procedures. The department also provides state agencies, CMAS vendors, and prospective vendors workshops and guidance, and has established processes that are designed to screen out irresponsible vendors. For fiscal year 1997-98, the department collected \$3.2 million in administrative fees and spent \$2.9 million on the CMAS program. In fiscal year 1998-99, the department collected \$4.3 million in administrative fees and spent \$2.3 million on the CMAS program. According to the department, surplus fees are used to subsidize the activities of other units within its procurement division.

SCOPE AND METHODOLOGY

The Bureau of State Audits conducted an audit of the CMAS program to follow up on our October 1998 report titled *State Contracting: The State Can Do More to Save Money When Acquiring Goods and Services*. This audit's primary purpose was to determine whether the CMAS program ensures that the State acquires products and services in a value-effective manner.

To assess the State's compliance with the laws, regulations, and policies governing contracts, we reviewed the California Public Contract Code, the State Administrative Manual, the California Acquisition Manual, and other department policies and procedures. From these sources, we identified provisions and policies pertaining to the CMAS program. We evaluated the original bill and bill analyses to understand the program's legislative intent. In addition, we reviewed the laws, regulations, and policies pertaining to the federal program because the CMAS program is partially based on it. Further, we consulted the legislative counsel to determine whether certain federal provisions were incorporated in the CMAS program.

To establish whether the State is acquiring products through CMAS in a value-effective manner, we selected five CMAS vendors for testing. We compared CMAS prices to those the vendors charged on comparable transactions to other customers in the private and public sectors. In determining whether transactions were comparable, we considered the date of purchase and the number of units per transaction. We then determined whether vendors charged CMAS customers appropriate and approved

prices. In addition, for the five vendors we selected, we determined whether they sold products or services they were not authorized to sell under their particular contracts.

The five vendors were selected based on the type of contract underlying their CMAS agreement (vendor-held or piggybacked contracts issued by federal or other entities), sales volume, products offered, and geographical location. We generally selected California companies that sell electronic data processing equipment and had high sales volumes in the third and fourth quarters of calendar year 1998. We intentionally selected electronic data processing equipment because it is difficult to identify comparable transactions for services since information technology services are generally unique to the agencies that request them. For the purposes of this report, we refer to the five vendors reviewed as vendors A through E. ■

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AUDIT RESULTS

Although the CMAS Program Has Improved the Procurement Process, It Does Not Ensure That the State Gets the Best Value

SUMMARY

The Department of General Services (department) developed the California Multiple Award Schedules (CMAS) program to reduce overall procurement cost by ensuring competitive prices without the expense of competitive bidding. Like other multiple award schedule programs, CMAS gives purchasers the authority to buy goods and services from a list of qualified vendors at or below approved prices.

Our previous audit of the department's procurement methods found that CMAS users paid higher-than-necessary prices when they did not comparison shop, and the audit recommended that comparison shopping be required. Although the department agreed that comparison shopping is needed to optimize the benefits of CMAS, it preferred to encourage rather than require state agencies to do so. Our current audit examined a sample of CMAS transactions to test vendor compliance with the terms of CMAS agreements and found that the State continues to pay more than necessary. We found several instances where CMAS vendors charged more than they should have. We also discovered that correct CMAS prices are difficult to determine and can have little practical importance in setting actual CMAS prices.

The department asserts that CMAS prices are fair and reasonable. However, the assumptions underlying this assertion are faulty. We also believe that the additional effort and expense of comparison shopping will be more than offset by improved CMAS prices. Therefore, we again recommend that the department require CMAS customers to comparison shop.

THE CMAS PROGRAM HAS ACHIEVED SOME OF THE OBJECTIVES OF THE ENABLING LEGISLATION

The CMAS program appears to have succeeded in reducing the State's administrative cost and improving the flexibility of day-to-day procurement of information technology goods and services. By permitting agencies to purchase these products and services without formally specifying, soliciting, and evaluating proposals from competing suppliers, CMAS eliminates much of the cost of competitive bidding. Procuring information technology goods and services via CMAS requires fewer staff hours and therefore lower costs than the traditional competitive bidding format, although the department has not quantified net savings to the State.

The CMAS program increases procurement flexibility by giving state agencies access to a wider range of solutions and vendors than traditional cost-effective bidding processes, which generally limited the purchaser to the lowest-priced solutions. The CMAS program allows state purchasing agents to exercise more discretion in selecting vendors, products, and services, and its streamlined purchasing format makes information technology goods and services available to agency customers on a more timely basis than through competitive bidding.

Unlike the previous information technology procurement rules, which focused on price as the key determinant of purchase decisions, value-based procurement permits purchasing agents to integrate qualitative factors—such as vendor reliability and expertise, warranty periods, and delivery schedules—into their decisions. By combining price and qualitative factors, purchasing agents can more accurately estimate and compare the overall value of products and services. Although price is not always the determining factor in value-based purchase decisions, it still plays an important role.

Although CMAS appears to have reduced administrative costs and improved procurement flexibility, the program does not ensure that purchases represent the best value.

The department adds value to the CMAS program by prequalifying vendors and applying standard contract provisions designed to protect the State. For example, its vendor screening process verifies corporation and authorized reseller status and promotes compliance with year 2000 requirements and drug-free workplace rules. The department also conducts vendor compliance reviews and offers administrative training to CMAS vendors and customers.

Because of its ease of use and flexibility, the CMAS program has become increasingly popular with users, as the rapidly growing annual volume of CMAS purchases demonstrates. It is also popular with the department, which considers expansion of the CMAS program a strategic goal. But in spite of the program's benefits, CMAS customers do not always benefit from the level of price protection intended by the department, and procedures do not ensure that CMAS purchases achieve the best possible value.

STATE PURCHASING AGENTS NEED TO RECOGNIZE THAT CMAS PRICES MAY NOT BE THE BEST AVAILABLE

Although CMAS is partially modeled on the federal program, the department does not require vendors to give state customers the lowest price available to corporate customers as the federal program does.

State purchasing agents need to recognize that the department does not assert that published or quoted CMAS prices necessarily represent the best prices available to state agencies. They are merely ceiling prices that a vendor is not to exceed, and not a best price. The department does not contractually require vendors to give state customers the lowest price they offer to comparable corporate customers as the federal Multiple Award Schedules program (federal program) does.

Although the CMAS program is partially modeled on the federal program and 86 percent of CMAS vendor agreements are based on federal contracts, CMAS prices do not enjoy the same protections as federal program prices. Moreover, the vast majority of CMAS contracts based on federal agreements are held by vendors that have obtained them by agreeing to provide the same products and prices as the companies holding the original base contracts. Although prices on these CMAS contracts are supposed to mirror underlying federal prices, in practice, federal program pricing does not always flow through to CMAS customers. We found that certain of these vendors do not systematically track the product and price changes of the base agreements underlying their CMAS contracts, and even if they do learn of changes, have little assurance that the changes have been authorized. Sometimes they set prices completely on their own and do not use the prices from the underlying federal schedules at all.

Before federal contracts are awarded, the federal government analyzes vendors' prices and negotiates discounts to ensure that prices are fair and reasonable and represent discounts equal to or better than those offered to comparable private-sector customers. The department's program staff do not perform pre-award

research to ensure that CMAS prices are fair, reasonable, and represent the best discounts available to comparable customers. Instead, program staff rely on federal pre-award auditing and negotiations, which may have occurred a few years earlier.

Furthermore, on an ongoing basis, the federal program requires vendors to give federal customers the lowest price they offer to comparable corporate customers. Even though the CMAS program does not have a similar requirement, it does have a provision designed to ensure that CMAS customers ultimately benefit from any declining federal prices. CMAS contract terms require that any “changes to the federal General Services Administration’s Multiple Award Schedules . . . prices and/or catalog shall be available to the state of California when they become effective for the Federal Government.” However, neither CMAS program staff nor certain CMAS vendors we reviewed regularly track changes and updates to the federal contracts underlying CMAS agreements. Without an accurate snapshot of underlying federal price schedules, CMAS customers may not benefit from declining federal prices.

The other 14 percent of CMAS agreements are not based on federal contracts but on contracts awarded by other entities, primarily counties or states. The law allowing the department to establish the CMAS program gave it wide latitude in implementing the program and in developing its own multiple award schedules. The law places no restrictions on the pricing mechanisms of CMAS agreements based on these contracts. The department’s policies require that these contracts be “competitively bid, compared and/or assessed.” But product pricing sometimes plays a minor role in these contract awards, and where price is the primary criterion, we question whether these other entities can negotiate as good a price as the federal government.

Customers do not always use CMAS prices as a ceiling for negotiations.

The department says that CMAS prices should serve as a ceiling for negotiations, and its contract language encourages CMAS customers to negotiate or shop for better prices. But our review shows that CMAS customers do not always use CMAS prices as a ceiling for negotiations, either because they do not know what the correct price is or because the vendor does not quote the correct CMAS price, or both.

Purchasing agents need to perform their duties recognizing that the department does not assert that published or quoted CMAS prices are the best prices available to the State, and buyers cannot expect to get the best value for the State's dollars without comparison shopping.

THE STATE FREQUENTLY PAYS MORE THAN DO OTHER TYPES OF CUSTOMERS

Because the CMAS program was not designed to provide the State with prices as low as those offered to other commercial or governmental customers, we found numerous examples where state agencies paid more than others did.

Because the program was not designed to produce the lowest price, CMAS customers can and do pay higher prices than other customers.

For example, in one transaction that we reviewed for a computer component, vendor A charged the State significantly more than it charged a commercial customer. Vendor A charged the State \$15,700 for the same component it had sold to a commercial customer approximately two weeks earlier for \$13,600, a difference of \$2,100. However, because the State purchased two of these components, it actually paid \$4,200 more than the commercial customer would have paid for the same number of components. The vendor did not explain this difference.

In another instance, vendor B charged the State \$6,800 for a computer component that it sold to another customer for \$6,300. This difference of \$500 multiplied by the three components purchased by the State represents a \$1,500 potential loss. The vendor's explanation for this price inequality was that the manufacturer had provided a one-time special offer. Although two commercial customers received this one-time offer during the same time period, the State did not.

In another case, vendor C sold the State a computer for \$2,300. A county purchased this same computer for \$2,000 and a city purchased it for \$1,800. All of these transactions occurred within approximately a one-week period. The State paid \$500 more for this product than the lowest price offered to another governmental customer, and the vendor's profit margin varied greatly, from a 5 percent margin on the city transaction to a 25 percent margin on the state transaction. The vendor said that the county benefited from a special discount offered by the manufacturer; however, the vendor could not explain why the city received a lower price.

Despite its size, the State is not considered a large-volume purchaser by vendors, and thus, it does not receive the best discounts available.

The previous examples illustrate that because the CMAS program was not designed to produce the lowest price, CMAS customers can and do pay more than commercial and other governmental entities for the same items. During our review, one vendor said that price variances can result from several factors, such as customer negotiation skills, good payment history, discounts for providing services along with products, urgency of need for a product or service, and competitive bids from rival vendors. Commercial customers also achieve better prices by agreeing to purchase a certain dollar amount of goods or services from a vendor during a specific time period. Under these agreements, customers are obligated to pay a penalty if they do not meet the required purchase volume.

Some vendors also said that the State does not always get the best price because it is a rather slow payer. The CMAS contract specifies that state agencies should pay vendors within 30 days of the receipt of the purchased item or the invoice, whichever is later. However, some vendors assert that most state agencies take an average of 60 to 90 days to pay. In addition, despite its size, the State is not considered a large-volume purchaser. Obviously, it is not effectively leveraging its combined purchasing power within the CMAS program. Our testing confirmed this; state agencies typically do not purchase large quantities of goods on individual orders, and therefore do not receive the best discounts available. In this type of environment, it is essential that state purchasing agents comparison shop to increase their likelihood of receiving the best value available when buying goods and services.

THE DEPARTMENT DOES NOT BELIEVE THE CMAS PROGRAM WAS INTENDED TO ENSURE THAT THE STATE RECEIVES THE LOWEST PRICES AVAILABLE

The State did not always get prices as low as those offered to comparable corporate or government customers because the department did not design the program with this objective. The department believes the concept of value-based purchasing in the enabling legislation was not intended to require the CMAS program to ensure the State receives the lowest available price. It believes that administrative and other unquantified cost savings of value-based procurement outweigh cost increases stemming from the program's pricing inefficiencies.

The department originally opposed the legislation allowing it to establish CMAS, voicing concern that the program would not require state agencies to purchase the least-expensive products. It noted that in the federal program, multiple vendors offer the same products at different prices. The department challenged the concept of value-based purchasing as “inadequately defined and extremely nebulous” and raised the concern that agencies may try to direct business toward certain vendors and be unwilling to accept comparable yet less expensive products from other vendors. Even after deciding to support the legislation, the department acknowledged that value-based purchasing would rely heavily on the personal judgment of agency decision makers.

The department strongly encourages, but does not require, CMAS customers to comparison shop to optimize the program’s benefits.

Given the department’s concerns, it is understandable that CMAS contract language strongly encourages state agencies to comparison shop to optimize the program’s benefits. However, the department declined to accept the recommendation in our October 1998 report to *require* comparison shopping for CMAS purchases on the grounds that such “process-driven” requirements are contrary to legislative intent and best-procurement practices. The department feels that requiring comparison shopping and informal supporting documentation would increase administrative costs by imposing an additional task on procurement agents. The department also believes that a comparison-shopping requirement would trigger protests of CMAS purchase decisions.

We believe the cost of requiring CMAS comparison shopping would not be excessive. For example, if a state purchasing agent making \$60,000 per year, including benefits, spent one hour determining the federal program price for an item and calling three vendors for quotes after deciding what type of item to purchase, the cost would be approximately \$30. If this practice resulted in the purchasing agent identifying a vendor offering a price 3 percent below other vendors, the State would save money any time the extended price of the items purchased (quantity ordered multiplied by item price) exceeded \$1,000. The examples discussed in a previous section demonstrate that prices can frequently fluctuate by far greater than 3 percent on any given product.

We also find it unlikely that vendors, particularly those wishing to attract future CMAS orders, would choose to incur the costs of a protest to try to reverse transactions that generally do not involve large quantities.

THE DEPARTMENT’S BELIEF THAT PRICES ARE FAIR AND REASONABLE IS BASED ON FAULTY ASSUMPTIONS

The department designed the CMAS program to support value-based purchasing by establishing processes that it thought would result in fair and reasonable prices. There are various underlying assumptions about the CMAS program that, if true, might provide state agencies with fair and reasonable prices. However, we found that several of these assumptions are faulty.

The Department Asserts That CMAS Prices Are Fair and Reasonable

The department asserts that CMAS prices are fair and reasonable because these prices are based on competitive assessments by the federal government or other entities. As discussed earlier, vendors that have existing federal contracts may participate in the CMAS program as long as they are willing to extend the same prices, terms, and conditions to CMAS customers. Initial federal program prices are deemed to be equivalent to competitively established prices.

The department also allows vendors to use other competitively established multiple award schedules as a basis for obtaining CMAS contracts. These entities—typically counties or states—generally use traditional competitive bidding processes to assess prices when establishing contracts. They solicit and evaluate bids for goods and services, and award a contract to the vendor with the most competitive bid. The department believes that the resulting prices are fair and reasonable because they were competitively established.

The department’s assertion that CMAS prices are fair and reasonable is also built on certain implicit assumptions. First, it is assumed that vendors are aware of current CMAS prices and items authorized for sale under the program. Second, it is assumed that vendors quote correct prices to customers. Finally, it is assumed that state purchasing agents can determine correct prices by reviewing CMAS catalogs, which should be up to date and useful procurement tools. CMAS contracts require vendors to provide product catalogs and current price lists to customers who ask for them, and state purchasing agents should be using these catalogs to make fully informed purchasing decisions. However, the program’s evolution and the dynamic nature of the information technology market have significantly weakened these assumptions and reduced the likelihood that state agencies using CMAS will receive fair and reasonable prices.

The program’s evolution and the dynamic nature of the information technology market have significantly weakened the assumptions on which CMAS was built.

The Department Undermined Its Assertion That CMAS Prices Are Fair and Reasonable by Allowing Piggybackers to Participate in the Program

The department's assertion that CMAS prices are fair and reasonable is based on the assumption that prices paid for CMAS purchases match, or are less than, prices that have been competitively assessed by the federal government or other entities. However, this assertion was undermined when it began allowing vendors without their own contract to obtain CMAS agreements by simply agreeing to provide the same products and prices as the companies holding the original base contracts.

Prices offered by piggybacking vendors do not always mirror those of the base contracts on which their CMAS agreements were established.

This arrangement, known as "piggybacking", permitted the department to greatly expand the number of vendors, resulting in increased competition and a wider range of products and services for CMAS customers to choose from. But the prices of the piggybackers we reviewed did not always accurately mirror those of the base contracts on which their CMAS agreements were established. With piggybacked agreements comprising 80 percent of the more than 2,000 CMAS contracts, we have concerns that state agencies are imprudently relying on CMAS prices. Our review indicates that government contracting authorities do not alert CMAS piggybackers to changes in their underlying contracts. Additionally, it is sometimes difficult, if not impossible, for piggybackers to obtain price changes from vendors holding the underlying contracts. These vendors have little incentive to share price changes with piggybackers because they can be in direct competition. Furthermore, because prices and products in the information technology market change so rapidly, it is unreasonable to expect CMAS vendors, some with dozens of piggybacked contracts, to keep up with all price and product changes.

The Assumption That the Program Is Functioning as Intended Is Also Faulty

Another assumption implicit in the department's belief that CMAS prices are fair and reasonable is that vendors' sales representatives are aware of and only offer authorized items at approved or lower prices. However, this assumption is flawed. First of all, as mentioned previously, there is little assurance that prices offered by piggybackers reflect changes that may have occurred on underlying base contracts. Second, vendors may not offer the correct CMAS price as it is unreasonable to expect that sales representatives would not be motivated to achieve the

highest sales price when negotiating with buyers who may not have verified the valid CMAS price and who may not have comparison shopped to determine if another vendor is offering the same item at a lower price.

Because CMAS catalogs are often outdated, state agencies cannot rely on them to verify that prices quoted by vendors are valid.

Further, it is assumed that state purchasers are able to verify that prices offered are valid current CMAS prices. However, this assumption is faulty as CMAS catalogs are often outdated. In fact, because products and prices in the information technology market change so rapidly, CMAS catalogs become obsolete soon after being printed. State agencies therefore need to be aware that they cannot rely on these catalogs to determine whether prices quoted by CMAS vendors are correct. At best, state agencies should view CMAS catalog prices as ceiling prices that should not be exceeded, but should only be used as places to begin negotiations.

Another problem with CMAS catalogs is that vendors often have little assurance that updates have gone through a formal approval process in which the prices are assessed for fairness and reasonableness. Although the federal government or other entities assess and approve initial catalog prices, vendors do not always know if subsequent revisions to these prices are reviewed by these entities. In certain cases, it appears clear that the price changes were not reviewed. Several vendors we visited had revised their CMAS price lists from the original approved catalog prices but were unable to provide evidence that any of the changes were formally approved by the entity that originally awarded the contract (federal government or other entity). Generally, the department does not review or approve these price changes either.

We found that because of the inherent limitations of these catalogs, they are not typically used to price CMAS products and services. Rather, when a state agency wishes to purchase a product through CMAS, it simply contacts an authorized vendor to obtain the CMAS price. Generally, the vendor's sales representative then determines the current manufacturer or distributor list price and the applicable CMAS discount. The resulting price represents a ceiling from which the vendor and customer negotiate a final price. Again, the vendor often has little assurance that this price has been reviewed for fairness and reasonableness, and unless the CMAS customer checks with other vendors, he or she is negotiating in the dark and has no basis of comparison to determine whether the price offered represents a good value.

THE FAULTY ASSUMPTIONS IMPLICIT IN THE CMAS PROGRAM HAVE LED TO HIGHER PRICES FOR STATE AGENCIES

The faulty assertions and assumptions implicit in the CMAS program make it difficult for state agencies to determine whether prices quoted by vendors are valid and current, let alone fair and reasonable. We found several instances in which CMAS vendors overcharged state agencies.

For example, vendor C's agreement stipulates that CMAS prices are determined by its cost plus a contractual profit margin. The margins specified in the contract range from 1 percent to 5 percent, depending on the type of product and the manufacturer. To determine whether this vendor overcharged the State, we reviewed eight state transactions. For each transaction, we obtained the vendor's underlying cost (from its distributor's invoice) and calculated the ceiling price allowable under CMAS using the margins specified in the contract. CMAS customers were overcharged in each of the eight transactions we reviewed, with the vendor's actual profit margin ranging from 4 percent to 25 percent. In one instance, the CMAS contract specified an allowable margin of 1 percent for a certain computer, which dictated a ceiling price of \$1,700. However, the customer actually paid \$2,300, or \$600 more than the allowable CMAS price, resulting in a 25 percent profit margin. The vendor said these overcharges occurred because sales representatives did not refer to the contract when negotiating CMAS prices. If the vendor had offered these products at the agreed-upon price, or if the customer had been able to verify the correct price, a fair and reasonable price might have been paid in each of these cases. Furthermore, if these state agencies had comparison shopped, they might have realized that the prices quoted by this vendor perhaps did not represent the best values.

One vendor overcharged a state agency, realizing a 25 percent profit margin, even though its CMAS contract only allowed a 1 percent margin on the transaction.

In another case, vendor D, who piggybacks onto more than 10 federal contracts, charged a state agency nearly \$500 more for a computer component than it should have. The price in effect at the time of the transaction was \$7,800, according to the vendor's updated CMAS price list, but the state agency paid \$8,300 for the item. Because the State bought three of the components, the vendor actually overcharged it nearly \$1,500. In this case, not only did the state agency not negotiate a discount from the CMAS list price, which was intended to be a ceiling price, but it also paid 6 percent more.

As discussed earlier, the assumption that CMAS vendors always quote the correct price is faulty, as shown by two additional examples of overcharging. Vendor A overcharged a state customer by more than \$700 for an item with a CMAS list price of \$15,000. Because the State purchased two of these items, it was actually overcharged nearly \$1,500. In this case, the sales representative apparently misquoted the price to the customer. When we brought this to the attention of vendor management, it stated that it was simply a mistake and agreed to issue a corrected invoice to the agency. However, this is another example of a vendor misquoting the CMAS price and the state customer agreeing to pay the higher price because it was not aware that the price quoted was inaccurate.

In a different example, a vendor overcharged the State \$4,400, partially because it did not know how to correctly price products under one of its CMAS contracts.

In another case, vendor E overcharged the State \$400 for each of 11 computers, a total overcharge of \$4,400. Not only did the sales representative quote the wrong price, but the vendor did not know how to correctly price products under this particular CMAS contract. The unit price quoted to the State by vendor E was not based on a CMAS catalog, as the catalog does not contain current prices. The vendor based the quote on a manufacturer's price list, which in this case was also out of date. Had the quote been based on an up-to-date list, both the vendor and the customer would have known that the product was discontinued. Instead, the state agency placed its order for the discontinued product at an outdated manufacturer's list price. The vendor later shipped a newer model in place of the discontinued model, but failed to ascertain the correct price of the newer model. The vendor later invoiced the State for the more expensive discontinued model.

This example also illustrates one of the problems with piggy-backing arrangements. In this case, the vendor, whose CMAS agreement piggybacked on a competing vendor's federal contract, did not know the correct base-contract prices. At the time of our review, vendor E had piggybacked onto more than 40 different federal contracts. The vendor stated that the base-contract holder would not share its federal contract prices. Additionally, the federal government does not inform piggybackers of changes. In the absence of accurate information, vendor E priced this and other products under this CMAS contract using a manufacturer's price list because it believed the prices of the underlying federal contract were based on a zero discount from the manufacturer's list price. However, according to the base-contract holder, the underlying federal contract

actually uses a cost-plus pricing formula. Because vendor E did not know the correct base-contract prices, and because it did not know how to develop them, it charged incorrect CMAS prices.

According to the base-contract holder, the underlying federal contract prices are well below the manufacturer's list prices used by vendor E to price CMAS transactions. It is therefore likely that the overcharge previously cited is understated. Vendor E acknowledges that it has been selling products under this CMAS contract without knowing what the correct prices are.

Finally, in addition to the previous examples, our vendor testing revealed several instances where it was difficult to determine a fair and reasonable price because the product was not even listed in the CMAS catalog. The main reason given by vendors for items not being on the CMAS price list is that they are new products offered by the manufacturer, a common occurrence in the fast-changing information technology market. Therefore, with these products, state procurement officers have no ceiling price from which to negotiate and, as previously mentioned, have little assurance that the price has been analyzed for fairness and reasonableness.

COMPARISON SHOPPING IS NECESSARY TO OPTIMIZE THE BENEFITS OF VALUE-BASED PURCHASING

State agencies cannot effectively evaluate value-based purchases by placing CMAS orders with the first vendor they call. Like the architects of the federal program on which CMAS is partially modeled, we believe that comparison shopping and value-based procurement go hand-in-hand. Even with its additional contractual protections, the federal program requires agency customers to do minimal comparison shopping before placing orders over \$2,500 with federal vendors.

Like the architects of the federal program on which CMAS is partially based, we find that comparison shopping and value-based procurement go hand-in-hand.

GSA Advantage, the federal General Services Administration's Internet-based ordering system, is a valuable resource that state agencies can use in their dealings with CMAS vendors. It allows them to search through federal program products and prices and select the item representing the best value for their requirements. Prices for information technology products sold through CMAS can generally be found on GSA Advantage, which is accessible to the public. These federal prices should be viewed as

ceilings that CMAS transactions should not exceed. However, we believe that the State can get even better value for its money by comparison shopping.

Comparison shopping to determine best value may involve considering qualitative factors, such as quality of the product and reliability of delivery schedules. However, a prudent customer should consider price as well when determining if a purchase represents the best value. In fact, in certain situations, such as when a customer has decided upon a particular model of computer to purchase, price is the key determinant of what is best value. As our review found, prices offered by vendors can differ on any given product, and thus comparing prices among vendors is necessary to ensure that the State receives the best value available.

We believe the benefits of comparison shopping would outweigh any additional costs.

State agencies should be required to obtain three “value quotes” from competing CMAS vendors for all purchases with an extended price of \$2,500 or more. Because we envision this process to be informal with minimal documentation needed, we believe that the benefits would outweigh any additional costs. State agencies should use the prices they obtain through GSA Advantage as benchmarks to evaluate the reasonableness of the CMAS quotes. We believe it is necessary to obtain competitive quotes, as CMAS catalogs and price lists can be outdated, and even GSA Advantage may not reflect recent market fluctuations.

The CMAS program creates a more competitive procurement environment by making a wider range of products and suppliers accessible to state purchasing agents. CMAS customers that do not exploit this rich competitive environment through comparison shopping defeat the purpose of value-based procurement.


RECOMMENDATION

The department strongly encourages state agencies to comparison shop to optimize the benefits of the CMAS program. However, to ensure that the State receives the best value for goods and services purchased through CMAS, the department should require state agencies to determine the latest available federal program price, whenever practical, and then comparison shop by obtaining three “value quotes” from competing CMAS vendors for all purchases with an extended price (quantity

ordered multiplied by item price) of \$2,500 or more. To further ensure that CMAS purchases are value-based, state agencies should negotiate for the best value available.

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 government auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,


for KURT R. SJOBERG
State Auditor

Date: August 26, 1999

Staff: Karen L. McKenna, CPA, Audit Principal
Michael Tilden, CPA
Corey Bock
Hitomi Sekine, CPA
Nicette Short

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Agency's response provided as text only:

State and Consumer Services Agency
915 Capitol Mall, Room 200
Sacramento, CA 95814

August 18, 1999

Kurt R. Sjoberg, State Auditor
Bureau of State Audits
555 Capitol Mall, Suite 300
Sacramento, California 95814

Dear Mr. Sjoberg:

RE: DEPARTMENT OF GENERAL SERVICES: THE CALIFORNIA MULTIPLE AWARD
SCHEDULES PROGRAM HAS MERIT BUT DOES NOT ENSURE THAT THE STATE
GETS THE BEST VALUE FOR ITS PURCHASE

Enclosed is our response prepared by the Department of General Services to the Bureau of State Audits' Report No. 99500 entitled "Department of General Services: The California Multiple Award Schedules Program has Merit but does not Ensure that the State gets the Best Value for its Purchases," as well as a copy of the response on a diskette.

If you have any questions or need additional information, please contact me at 653-4090.

Sincerely,

(Signed by: Clothilde V. Hewlett)

Clothilde V. Hewlett
Undersecretary

Enclosures

MEMORANDUM

Date: August 18, 1999

File No.: 99500

To: Aileen Adams, Secretary
State and Consumer Services Agency
915 Capitol Mall, Room 200
Sacramento, CA 95814

From: **Department of General Services
Executive Office**

Subject: **RESPONSE TO BUREAU OF STATE AUDITS' REPORT NO. 99500 - "THE CALIFORNIA MULTIPLE AWARD SCHEDULES PROGRAM HAS MERIT BUT DOES NOT ENSURE THAT THE STATE GETS THE BEST VALUE FOR ITS PURCHASES"**

Thank you for the opportunity to respond to Bureau of State Audits' (BSA) Report No. 99500 which addresses a recommendation to the Department of General Services (DGS). The following response addresses the recommendation which pertains to operations within the California Multiple Award Schedules (CMAS) program.

OVERVIEW OF THE REPORT

The DGS has reviewed the findings and recommended action presented in Report No. 99500. As discussed in this response, the DGS will take appropriate actions to address the recommendation which involves requiring value shopping by state agencies.

Overall, the DGS is pleased that the BSA's second extensive and in-depth audit of the CMAS program within a ten-month period did not identify any new issues with the efficiency and effectiveness of the program. In brief, the BSA's current report repeats the primary finding and recommendation contained in its October 1998 report on CMAS program operations. Specifically, the BSA continues to believe that the CMAS program would be improved by the DGS adding additional control requirements related to value shopping.

In previous correspondence with the BSA and extensive discussions with its staff, the DGS has presented its position that a change from its current policy of encouraging value shopping to requiring this activity would represent a fundamental shift in the CMAS program and be contrary to legislative intent and best procurement practices. The DGS continues to maintain this position. However, as discussed in this response, additional actions are being taken to ensure that CMAS customers and suppliers are fully aware of and comply with program requirements. The DGS believes these actions which include additional auditing, training and educational activities will result in operational improvements that address the BSA's findings related to value shopping.

*California State Auditor's comments on this response are on page 33.

Although the DGS' Procurement Division (PD) has oversight responsibility for the CMAS program, each state or local government entity is ultimately responsible for its own purchasing program. Under the CMAS program, it is the procurement entity that is responsible for determining the degree of effort to be made in obtaining best value for the commodity or service being procured. By placing this responsibility at the procurement entity level, the party with direct knowledge of the circumstances of a particular procurement is making operational decisions and, therefore, accountable for the procurement. This placement of responsibility is a key ingredient in ensuring that the procurement process is streamlined to remove repetitive, resource intensive, costly and time consuming processes.

The success of the CMAS program in meeting customer needs is shown by the significant growth in the amount of total annual CMAS procurements since the start of the program in May 1994. As noted in the BSA's report, the program has grown in purchases from \$84 million in the 1994/95 fiscal year to \$500 million in the 1998/99 fiscal year. Further, the DGS continually receives positive feedback from customers that the CMAS program is a useful and valuable tool for making prompt value-effective acquisitions. In fact, the five major state departments included in the BSA's prior CMAS audit all had positive comments related to the DGS' shift from a control orientation to a customer service orientation. These comments reflect favorably on the CMAS program which is a key acquisition methodology developed as part of this shift.

Also, the CMAS program has been very successful in ensuring that small businesses are given opportunities to participate within the procurement process. Of particular importance are the CMAS program provisions that allow businesses, including small businesses, to piggy-back on federal General Services Administration agreements. The allowance of piggy-backing greatly encourages the participation of small businesses in the program due to many factors including reductions in the complexity and costs of the contracting process. In brief, a small business supplier may establish their own CMAS agreement by simply agreeing to provide the same products and prices as the companies holding the original base contract. Because of the piggy-backing provisions and the freedom allowed to customers to consider value shopping factors other than just price in making an acquisition decision, the usage of certified small business suppliers has grown to be approximately \$78 million or 16% of CMAS procurements within the last fiscal year. This usage rate is significantly higher than the rate of small business usage derived from other acquisition methods.

It is also anticipated that the use of small businesses within the CMAS program will continue to grow with the implementation of Assembly Bill 2405, effective January 1, 1999. This bill required the establishment of a Small Business Advocate in each state agency. Further, it provides that, prior to placing CMAS orders, state agencies must first consider orders from small businesses whenever practicable. While not completely addressing the BSA's recommended action that three "value quotes" be obtained for each purchase, the requirement to consider small businesses prior to placing an order adds another level of value shopping to the CMAS program.

While continuing to believe that value shopping should not be required, over the last year the DGS has recognized that additional actions need to be taken to ensure that suppliers are complying with CMAS contract provisions related to pricing. In brief, resources have been added to ensure the performance of additional supplier and state agency compliance reviews and audits. Further, additional actions have been taken related to educating and training CMAS

users. Although currently on-hold due to the state's Y2K policies, the PD also plans to implement an on-line CMAS catalog which will contain more extensive information on suppliers, products and prices. The taking of these actions should assist in ensuring that CMAS customers and suppliers are fully aware of their responsibilities under the CMAS program and have additional resources to accurately identify product and price information.

In conclusion, although recognizing that a number of additional actions should be taken to improve supplier compliance with CMAS contract provisions, the DGS continues to believe that the CMAS program is an example of a value-driven, highly successful procurement process that has resulted in a significant reduction in duplication of efforts among governmental entities and, therefore, substantial savings to the state's taxpayers. The DGS is not aware of any desire by its legislative, state agency or local government customers to add additional control requirements to this program.

The following response only addresses the recommended action. Since they have been extensively discussed in past meetings with the BSA's staff, our disagreements with some specific findings and resulting conclusions will not be repeated in this response.

RECOMMENDATION

RECOMMENDATION:

The Department of General Services (department) strongly encourages state agencies to comparison shop to optimize the benefits of the CMAS program. However, to ensure that the State receives the best value for goods and services purchased through CMAS, the department should require state agencies to determine the latest available federal program price, whenever practical, and then comparison shop by obtaining three "value quotes" from competing CMAS vendors for all purchases with an extended price (quantity ordered times item price) of \$2,500 or more. To further ensure that CMAS purchases are value-based, state agencies should negotiate for the best value available.

DGS RESPONSE:

The DGS' position related to requiring value shopping is extensively discussed in the Overview section of this response. Although not believing that CMAS procedures should be revised to require value shopping, the PD has taken and plans to take a number of actions to ensure that CMAS customers and suppliers are fully aware of and comply with program requirements. As with any new program, during the first few years of the CMAS program resources have been focused on implementation activities such as determining the eligibility of suppliers, processing contracts and conducting outreach activities. With the maturing of the program, over the last year the PD has begun focusing additional resources on ongoing program oversight activities. As these activities are fully implemented, it is our belief that conditions such as those found in

the audit related to overcharging by suppliers and the apparent lack of smart shopping by customers will be greatly reduced. The following paragraphs briefly discuss these oversight activities.

With the exceptional growth in CMAS usage over the last few years, the PD recognizes that further resources need to be dedicated to verifying supplier compliance with contractual requirements in a timely manner. Therefore, the feasibility of adding four additional positions to its supplier compliance review function is currently being determined. It should also be noted that the PD has already taken some significant actions to improve the efficiency and effectiveness of the compliance review activity. Specifically, in November 1998, the PD transferred two positions and the responsibility for performing supplier compliance reviews from its CMAS Unit to its System Integrity Unit. This dedication of resources specifically to CMAS supplier compliance review activities has resulted in an increase in the number of reviews conducted annually. Currently, the System Integrity Unit has implemented detailed procedures for the reviews and developed a plan to annually conduct reviews of the top 20 CMAS suppliers.

In addition, to verify that state agency users are aware of their responsibilities for being smart shoppers, the DGS Audit Section has revised the scope of its compliance audits of the largest state departments to provide for the review of CMAS transactions. Further, the PD has added tests of CMAS transactions to its information technology and commodity delegation review activities performed at state agencies.

The PD is also continuing to take actions to ensure that CMAS customers and suppliers are fully aware of their programmatic responsibilities. For customers, this activity includes the CMAS agreements containing language that strongly encourages each user to optimize the benefits of the program by comparing different schedules for varying products, services and prices, and carefully reviewing all contract terms and conditions to obtain the best value available. In addition to the language contained in the CMAS agreements, the users' responsibility for being a smart shopper has been emphasized in over 100 outreach activities performed by CMAS program staff. Further, the PD's Price Analysis Workshop training course is being revised to provide additional information on user responsibilities within the CMAS program.

Additionally, the PD is in the process of developing a new acquisition manual entitled the California Acquisition Manual for use as a resource in making acquisitions of commodities and information technology goods and services. It is planned that a complete draft of this manual will be available by December 31, 1999. However, a draft of the CMAS portion of the manual will be distributed for customer comment by the end of September 1999.

For suppliers, the CMAS Unit is in the process of issuing instructions to assist them in more readily obtaining current federal pricing information. This action should assist in addressing an issue identified by the BSA involving piggy-backers often having difficulty finding-out current CMAS prices. The instructions will be included in a CMAS bulletin to be issued in the near future and incorporated into future CMAS agreements.

Finally, to allow CMAS customers to have an additional tool to more easily comparison shop, the DGS plans to develop and implement the California Statewide Procurement Network (CSPN). This system is currently on hold by the Department of Information Technology due to the state's

● Y2K policies. However, when the CSPN goes online it will contain extensive information on CMAS products and prices which will greatly assist customers in being smart shoppers. In the interim, the CMAS program will soon feature a new Internet search tool on the CMAS web site that will allow customers to search for CMAS contractors offering a particular product and/or service they wish to purchase. While this will not provide specific product and/or service pricing, it will enhance the customers knowledge of the various CMAS contractors offering a product and will enhance their comparison shopping.

CONCLUSION

The DGS has a firm commitment to provide efficient and effective oversight of the CMAS program. As part of its continuing efforts to improve policies over this program, the DGS is taking the previously discussed actions to address the issues presented in the report. Further, the PD will issue a policy bulletin to CMAS suppliers and customers discussing the BSA's findings and the DGS' expectations of full compliance with CMAS program requirements.

If you need further information or assistance on this issue, please call me at 445-3441.

(Signed by: Cliff Allenby)

CLIFF ALLENBY, Interim Director
Department of General Services

CA:RG:ea:worddata:director:99500rpt

COMMENTS

California State Auditor's Comments on the Response From the Department of General Services

To provide clarity and perspective, we are commenting on the Department of General Services' response to our audit report. The numbers below correspond to the numbers we have placed in the response.

- Although additional auditing, training, and education may be beneficial, these activities are not substitutes for comparison shopping. We feel that requiring state agencies to comparison shop by obtaining value quotes for all purchases with an extended price of \$2,500 or more is a more cost-effective way of ensuring that the State receives the best value for the goods and services purchased through CMAS.
- If the California Statewide Procurement Network (CSPN) is successfully developed and implemented, it would likely be beneficial to the CMAS program. However, we question whether the development and implementation of this system would be as cost-effective as our comparison-shopping recommendation. Additionally, even if CSPN is successfully implemented, it would still be necessary for state agencies to obtain updated competitive quotes as CSPN may not reflect recent market fluctuations.

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