

Department of General Services

It No Longer Strategically Sources Contracts and Has Not Assessed Their Impact on Small Businesses and Disabled Veteran Business Enterprises

REPORT NUMBER 2009-114, JULY 2010

Department of General Services' response as of December 2010

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits (bureau) review the Department of General Services' (General Services) strategically sourced contracting practices and the effects these practices have on California small businesses and disabled veteran business enterprises (DVBEs). Specifically, the audit committee asked that we evaluate General Services' procedures for establishing strategically sourced contracts and determine how General Services ensures that small businesses and DVBEs are given an equitable opportunity to be chosen as strategically sourced contractors. We were asked to select a sample of strategically sourced contracts and determine if the justification for the contract met the applicable and established criteria; if General Services followed applicable laws, regulations, and policies and procedures when entering into contracts; and how General Services evaluated contractor compliance with laws related to providing commercially useful functions. The audit committee also requested that we evaluate General Services' policies and procedures to ensure compliance with contract terms of strategically sourced contracts.

If General Services tracks such information, the audit committee asked the bureau to calculate the ratio of strategically sourced contracts awarded to small businesses and DVBEs compared with all strategically sourced contracts. It further requested that we compare the number of small business and DVBE contracts for the two years before the implementation of strategic sourcing with the number of small business and DVBE contracts since General Services implemented strategic sourcing. The audit committee also asked us to compare the number of strategically sourced contracts during fiscal years 2007–08 and 2008–09 with all contracts entered into during the same period.

We also were asked to review and assess General Services' process for evaluating and estimating benefits to the State of strategically sourced contracts, as well as to determine whether General Services compares the ultimate cost savings of the strategically sourced contracts with preliminary estimates of cost savings from its analysis. Finally, the audit committee requested that we identify the changes in the number of staff in General Services' Procurement Division since the inception of the strategic sourcing initiative and determine the reasons for any increase in staffing.

Audit Highlights . . .

Our review of the Department of General Services' strategically sourced contracting practices revealed that it:

» *Awarded 33 statewide sourced contracts for 10 categories of goods between February 2005 and July 2006. Further, it:*

- *Accrued at least \$160 million in net savings as of June 30, 2007.*
- *Paid the consultant that assisted in implementing the strategic sourcing initiative 10.5 percent of the accrued savings realized through these contracts.*
- *Did not continue to formally calculate the savings after June 2007 when its consulting contract expired.*

» *Has not strategically sourced 20 other categories of goods or services, which were recommended by the consultant, and had not prepared an analysis to document its rationale for not strategically sourcing.*

» *Incurred significant costs to train staff and to develop written procedures on strategic sourcing, yet has not awarded any new strategically sourced contracts using the procedures or reviewed comprehensive purchasing to identify new opportunities.*

» *Lacks data to determine the impact of strategic sourcing on the participation by small businesses and Disabled Veteran Business Enterprises (DVBEs).*

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- » *Does not monitor small business and DVBE subcontractors to ensure that they perform commercially useful functions in providing goods or services once a contract has been awarded.*
- » *Does not have standard procedures to recover any overcharges identified despite its new automated process designed to monitor compliance with contract pricing terms.*

Finding #1: General Services' initial strategic sourcing efforts resulted in significant savings.

General Services awarded a contract in June 2004 to CGI-American Management Systems (CGI) to assist it in identifying and creating strategically sourced contracts in response to a recommendation of the California Performance Review. General Services' documents indicate that the State realized at least \$160 million in net savings through June 2007 as a result of the initial strategic sourcing efforts with the help of CGI. Those savings exceeded the estimates for eight of the 10 categories implemented. General Services paid CGI 10.5 percent of the savings gained under the strategically sourced contracts, and the State continued to use strategically sourced contracts after CGI's contract expired. After the end of CGI's contract, however, General Services changed the way it tracked savings, and as a result the total amount of savings, estimated by General Services to be substantial, is unknown.

Further, 28 of the original 33 strategically sourced contracts have expired, and the remaining five were scheduled to expire by July 2010. Although General Services has rebid or extended 26 of the 28 contracts that have expired, its management acknowledges that the historical information used by CGI in recommending strategically sourcing various goods and services and measuring related savings may no longer be relevant because that information was based on purchases during fiscal years 2002–03 and 2003–04. As a result, General Services would need to examine the State's recent purchasing patterns to determine the expected future savings for the various items.

We recommended that General Services ensure that it determines savings to the State going forward for strategically sourced contracts by examining the State's recent purchasing patterns when determining whether to rebid or extend previously strategically sourced contracts and when estimating expected savings. It should subsequently compare the savings it achieves to the expected savings for those contracts.

General Services' Action: Partial corrective action taken.

General Services states that it has developed standards for implementing and documenting the evaluation of recent purchase patterns when determining whether to extend, rebid, or retire previously sourced contracts. It notes that it did so in July 2010 by updating its procedures manual to incorporate detailed requirements for the development of opportunity assessments and sourcing work plans. General Services also states that it is piloting the use of a work plan template that contains detailed information on savings expected from the proposed sourced contract. It expects to complete the pilot project and incorporate lessons learned into a final work plan template in June 2011. General Services reports that subsequently it will compare the baseline savings amounts to the actual pricing obtained under an executed contract to calculate achieved savings.

Finding #2: General Services has not entered into new strategically sourced contracts.

General Services has strategically sourced no new contracts, even though it has created a unit that is tasked with, among other duties, identifying additional strategic sourcing opportunities and even though it paid for training and a procedures manual to do so. In addition to the 10 categories for which General Services originally awarded strategically sourced contracts, CGI had identified an additional 20 categories as good candidates for strategic sourcing. When we inquired about strategic sourcing efforts after CGI's contract ended, we learned that although its Intake and Analysis Unit (IAU) performs opportunity assessments for statewide contracts, General Services has not awarded any new contracts using the strategic sourcing procedures it developed. Further, when we looked into General Services' specific progress on CGI's recommendations, we found that it had not prepared any kind of comprehensive analysis documenting its attempts to strategically source the additional categories or its rationale for not strategically sourcing. General Services indicated it has awarded various contracts to address many of the categories recommended by CGI. However, none of these contracts were based on analyses prepared by the IAU, which is responsible for strategic sourcing efforts.

Further, management stated that although strategic sourcing has yielded significant results, General Services has achieved similar benefits through the use of more traditional, less resource-intensive methods. However, General Services has not determined whether its traditional methods have resulted in the maximum savings possible through strategic sourcing. Further, it is not reviewing comprehensive purchasing data that would allow it to effectively identify new opportunities. Instead, when it performs opportunity assessments to determine if strategic sourcing is warranted, General Services primarily considers the usage information it receives for existing statewide contracts. It is not considering other purchases made by state agencies. However, General Services noted that it plans to use its eProcurement system, which includes the State Contracting and Procurement Registration system (SCPRS), for strategic sourcing purposes.

We recommended that General Services conduct its planned review of CGI-recommended categories that it did not strategically source to determine if there are further opportunities to achieve savings to ensure that it has maximized the savings for these categories. Further, General Services should follow the procedures for identifying strategic sourcing opportunities included in the IAU's procedures manual to maximize the savings to the State for future purchases. In addition, to effectively identify new strategic sourcing opportunities, General Services should work to obtain comprehensive and accurate data on the specific items that state agencies are purchasing, including exploring options for obtaining such data for agencies that do not have enterprise-wide systems and therefore would not be using the additional functionality of the eProcurement system. Until it obtains such data, General Services should work with state agencies to identify detailed purchases for categories that it identifies through SCPRS as viable opportunities for strategically sourcing. For example, if based on its review of SCPRS data, General Services identifies a particular category that it believes is a good candidate for strategic sourcing, it should work with those state agencies that accounted for the most purchases within the category to determine the types and volume of specific goods purchased to further analyze the types of goods to strategically source. General Services should assess any need for additional resources based on the savings it expects to achieve.

General Services' Action: Partial corrective action taken.

General Services reported that it completed its review of CGI-recommended categories that it did not strategically source and concluded that none of the 20 categories warranted additional strategic sourcing contracting efforts. General Services noted that its review confirmed that it used other traditional acquisition techniques to acquire those goods or services that accomplished the same goal as strategic sourcing. It noted that for the remaining categories, such as architectural and engineering services, electricity, and leased real property, the review determined that the categories were of such a broad nature that strategic sourcing techniques could not be applied. In response to our request for documentation of the analysis performed that resulted in its conclusions, General Services provided a document of about three pages. The document commented on the results of each of the categories for which it or others conducted traditional (nonstrategic sourcing) acquisition methods. For many of the categories, General Services indicated that either savings would be measured by individual contract or savings were not measured. Additionally, General Services described the factors that it believes prevent strategic sourcing of other categories.

Further, General Services indicates that it periodically reviews databases, including the SCPRS data, for items that may indicate a strategic sourcing opportunity. It states that, in consultation with its customers, it uses available data on purchasing patterns to identify if strategic sourcing or another procurement vehicle should be used. General Services believes that these steps are sufficient to allow it to obtain comprehensive and accurate data on the specific items that state agencies are purchasing that are of a volume that warrant an opportunity for strategic sourcing. General Services states that it goes through an extensive search for purchasing data using all available sources and that it requests copies of purchase orders from state agencies to obtain more detailed purchasing data. However, it is unclear to what extent General Services implemented new procedures since the audit, nor was it able to provide, within the time frames needed for this report, information that would allow us to fully substantiate the actions it reported taking.

Finding #3: Effects of strategic sourcing on small businesses and DVBEs are not known.

Although strategic sourcing achieves lower prices by consolidating state expenditures into fewer contracts, consolidating state contracts also can result in fewer contracting opportunities for small businesses and DVBEs. To determine any change in small business and DVBE participation, General Services would need participation data, including the number of small businesses and DVBEs participating in state contracts, for these contracts both before and after it strategically sources the goods. However, General Services currently has only some of the small business and DVBE participation data necessary to measure the impact of strategic sourcing. General Services recognized that strategic sourcing could affect state agencies' ability to reach small business and DVBE participation goals; for these contracts it provides state agencies with the alternative of contracting directly with small businesses and DVBEs in order to mitigate this effect. This alternative is referred to as an "off ramp." General Services does not know how often state agencies use the off ramp, however, so it cannot evaluate its effectiveness in providing opportunities for small business and DVBE participation.

To provide decision makers with the information necessary to determine the true costs and benefits of strategic sourcing, we recommended that General Services evaluate any impact strategic sourcing has on small business and DVBE participation in terms of the number of contracts awarded and amounts paid to small businesses and DVBEs within the categories being strategically sourced. Specifically, for goods that were strategically sourced, General Services should compare the number of contracts awarded to small businesses and DVBEs before they were strategically sourced with those awarded through such contracts after they were strategically sourced. This effort

should include contracts awarded by General Services and other state agencies. Further, we recommended that General Services track the number and dollar amounts of contracts that state agencies award through the use of off ramps in strategically sourced and other mandatory statewide contracts to evaluate the effectiveness of the off ramp in providing opportunities for small business and DVBE participation. Its evaluation also should consider the extent to which an off ramp affects the monetary benefits that result from statewide contracts designed to leverage the State's purchasing power.

General Services' Action: Partial corrective action taken.

General Services states that before performing an acquisition, it includes an assessment of the number of small businesses and DVBEs that participated in the previous solicitation and the potential number of small businesses and DVBEs that will be participating in the new solicitation. As for tracking the use of small business and DVBE firms after a strategically sourced contract has been awarded, General Services has decided to capture and track that information for each statewide contract under its purview. General Services states that it is maintaining a database for tracking purposes of approved small business or DVBE off-ramp purchases, which includes pricing information. It plans to use this information to assess the impact on small businesses and DVBEs after strategic sourcing. General Services is piloting the new off-ramp usage tracking process using one statewide contract and anticipates completing the pilot phase and finalizing procedures within the first quarter of the 2011 calendar year.

Finding #4: General Services does not monitor for ongoing commercially useful function compliance.

State law requires that small business and DVBE contractors and subcontractors participating in state contracts must provide a commercially useful function in furnishing services or goods that contributes to the fulfillment of the contract requirements. When awarding the contract, General Services relies on contractor declarations that the small business and DVBE subcontractors will perform activities that comply with these requirements. Although General Services might request clarification on the proposed role of these subcontractors, it does not verify the role they play once the contract is awarded. Management stated that the individual state agency making the purchase is responsible for validating that subcontractors complied with commercially useful function requirements by obtaining from the contractors the necessary information that includes subcontractor name and dollar amount that can be claimed. Management pointed to a specific section in the State Contracting Manual as addressing the state agencies' responsibilities in this area. However, the State Contracting Manual section states only that state agencies can claim purchases toward their small business or DVBE goals whenever a contractor subcontracts a commercially useful function to a certified small business or DVBE. It also states that the contractor will provide the ordering state agency with the name of the certified small business or certified DVBE used and the dollar amount the ordering agency can apply toward its small business or DVBE goal. However, the State Contracting Manual does not provide specific guidance on how state agencies are expected to verify that small business and DVBE subcontractors actually performed commercially useful functions.

We recommended that General Services develop guidance for state agencies on how to ensure that subcontractors perform commercially useful functions if it believes state agencies making the purchases through statewide contracts should be responsible for this task. In addition, General Services should monitor, on a sample basis, whether state agencies are ensuring compliance with these requirements. General Services could leverage its efforts by working with other state agencies to ensure that subcontractors claiming to have provided the goods and services to the purchasing agency did, in fact, perform the work for which they are invoicing the state agencies.

General Services' Action: Partial corrective action taken.

General Services states that it will ensure that user instructions for future statewide contracts contain provisions that fully inform the user state agency of commercially useful function requirements. Further, General Services notes that it is in the process of implementing the use of contract management plans that clearly document the responsibilities of its contract administrators. Where applicable, these plans are to include a requirement for ensuring, on at least a sample basis, contractor compliance with commercially useful function requirements. General Services reports that policies and procedures for implementing the contract management plan process are currently in draft form with finalization expected within the first quarter of the 2011.

Finding #5: General Services' new process for verifying pricing compliance needs further attention.

Although General Services now has a process to identify noncompliance with contract pricing terms for statewide goods contracts, it does not always follow up on the identified noncompliance to ensure prompt recovery of overcharges and does not have a process to help ensure the accuracy of the purchasing data contractors report. General Services believes that individual state agencies making the purchases are responsible for ensuring that contractors comply with the contract's pricing terms. Nevertheless, it has implemented a new process as an additional tool for ensuring compliance with pricing terms. General Services began an automated process of ensuring contractors' compliance with contract pricing terms in August 2008 when it implemented the Compliance and Savings Administration (CASA) system. Our review of selected items found that although the CASA system appropriately processed usage data reported by contractors and identified discrepancies between the prices in usage reports and the respective contract's pricing terms, General Services has not yet developed standard procedures to recover overcharges. Further, General Services does not verify the accuracy of the purchasing data that contractors report. Thus, it cannot be certain that contractors always charge the agreed-upon prices.

We recommended that General Services implement standard procedures to recover overcharges identified by the CASA system. General Services' new procedures should specify the amount of time it considers reasonable to recover funds due back to the State. We further recommended that General Services improve the integrity of its monitoring of pricing compliance by implementing procedures to help ensure that usage reports reflect the actual items received and prices paid by the state agencies that purchased the items. For example, on a periodic basis, it could select a sample of purchases from the usage reports and work with purchasing state agencies to confirm that the prices and quantity of items reported reconcile with the invoices submitted by the contractor.

General Services' Action: Partial corrective action taken.

General Services is developing standard procedures to recover any overcharges, including the amount of time considered reasonable to recover funds due back to the State. The procedures are to provide for the prompt issuance of a "cure letter" upon identification of an overcharge amount. General Services states that it will also promptly follow up to collect any delinquent amounts. It reports that the procedures are in the final stages of completion and anticipates implementation within the first quarter of 2011. Additionally, General Services plans to implement procedures to assist in ensuring the accuracy of the usage reports submitted by contractors. The contract management plan process mentioned in General Services' comments

on Finding 4 is to include steps for the contract administrator to work with state agencies to confirm the accuracy of contractor reported pricing and other relevant data. To ensure the validity of the contractor's usage reporting, the steps are to include sampling purchasing agency documents and reconciling that data with usage report information.

