

REPORT 2009-114 SUMMARY - JULY 2010

Department of General Services: It No Longer Strategically Sources Contracts and Has Not Assessed Their Impact on Small Businesses and Disabled Veteran Business Enterprises

HIGHLIGHTS

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

- Awarded 33 statewide strategically 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 good 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 data 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).
- 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.

RESULTS IN BRIEF

The Department of General Services (General Services) serves as the business manager for the State and has the authority to establish various types of contracts that leverage the State's buying power. State law provides General Services with broad powers for carrying out its responsibilities. Depending on the volume of purchases for certain goods, General Services might enter into a statewide contract for state agencies to use in meeting their needs. In June 2004, in anticipation of a recommendation by the governor's California Performance Review, General Services awarded a three-year contract to CGI-American Management Systems (CGI) to assist in implementing its strategic sourcing initiative. The purpose of strategic sourcing was to enter into statewide contracts that leveraged the State's purchasing power to save money on the goods and services purchased most frequently by state agencies. The strategic sourcing process involved identifying those goods and services through a systematic analysis of past purchasing data and projecting what savings could be expected through the new contracts. Based on CGI's recommendations, General Services awarded 33 statewide contracts for 10 categories of goods between February 2005 and July 2006.

General Services' documents indicate that the State accrued at least \$160 million in net savings as of June 30, 2007, as a result of its initial strategic sourcing efforts through CGI. The contract required General Services to pay CGI 10.5 percent of the accrued savings realized through the strategically sourced contracts. Accrued savings were computed based on the difference between historical prices and the new contract prices, and our review of some of the savings calculations found them to be accurate. We also performed selected calculations using the actual prices paid by state agencies for goods purchased under the strategically sourced contracts, which sometimes differed from contract prices because state agencies negotiated lower prices than the maximum prices established in the contracts or because they paid more than stated in the contract. Nevertheless, the accrued savings calculations we reviewed were either less or very close to the actual savings realized by the State. General Services did not continue to formally calculate the savings after June 2007, when it no longer used those figures to determine the

payment to CGI. General Services has since rebid or extended many of these statewide contracts. Its management acknowledges that the State's purchasing information from fiscal years 2002-03 and 2003-04, which was used by CGI in recommending strategically sourcing various goods and services and measuring related savings, may no longer be relevant. Therefore, General Services would need to examine the State's recent purchasing patterns to determine the savings it can expect on various items.

Further, although General Services has not strategically sourced 20 other categories of goods or services that CGI recommended, it indicates that the State has awarded contracts to address many of these categories. However, we found that General Services had not prepared any kind of comprehensive analysis documenting its attempts to strategically source these categories or its rationale for not strategically sourcing. General Services states that CGI's strategic sourcing method is very resource-intensive. It noted that working within the current fiscal environment, it has used traditional methods of awarding contracts that it believes have achieved savings similar in significance to strategic sourcing. However, General Services has not determined that these contracts have resulted in savings to the State commensurate with what it would have achieved had it used strategic sourcing. Although the information provided by General Services during our audit indicated the savings may be considerably less than what CGI once estimated, General Services told us that it would again review the categories under its purview to determine if there are further opportunities to achieve savings.

General Services created its Intake and Analysis Unit (IAU) in 2006 to, among other duties, identify strategic sourcing opportunities. Further, General Services incurred significant costs by contracting with CGI to train IAU staff and to develop written procedures on strategic sourcing. The IAU does perform opportunity assessments, which are the first step required by its procedures manual to identify new items to strategically source. However, General Services has not awarded any new strategically sourced contracts using the procedures. Additionally, it is not reviewing comprehensive purchasing data that will allow it to identify new opportunities effectively. Instead, when it performs opportunity assessments to determine if strategic sourcing is warranted, it primarily considers the usage information it receives for existing statewide contracts. In addition to ensuring that it has maximized whatever savings are available in the categories that CGI recommended, General Services needs to consider new strategic sourcing opportunities through a detailed review of the State's purchasing patterns.

General Services' management noted that they plan to use the data in the State Contracting and Procurement Registration System (SCPRS) for strategic sourcing purposes. SCPRS is a database state agencies use to input information related to purchasing documents, such as contracts exceeding \$5,000. However, SCPRS data can be unreliable and do not have the level of detail necessary to allow General Services to identify the specific goods purchased. Management stated that SCPRS, although not perfect, will give General Services an estimated valuation of expenditures by category to consider. Their comments indicate that until they obtain a comprehensive source of statewide data, obtaining detailed purchasing data useful for strategic sourcing purposes will involve using SCPRS as a starting point to target potential opportunities and then working with selected state agencies to obtain the necessary data.

General Services takes steps to ensure that small businesses and Disabled Veteran Business Enterprises (DVBEs) are given equitable opportunities to be chosen for a contract. However, the very nature of strategic sourcing, which consolidates expenditures into statewide contracts to achieve lower prices, also can result in fewer contracting opportunities for small businesses and DVBEs. For certain mandatory statewide contracts, including strategically sourced contracts, General Services provides state agencies with the option to contract directly with small businesses and DVBEs in order to meet their required participation goals.

Nevertheless, the extent to which strategic sourcing has affected the number of small businesses and DVBEs contracting with the State is unclear. General Services does not have all the necessary data to determine the change in the number of these entities participating in a category of goods that was strategically sourced. Our review of all contracts awarded to small businesses and DVBEs by five large state agencies, which was based on reported data that was limited in its usefulness, does not indicate a clear relationship. Without such data, General Services cannot measure the impact of strategic sourcing on the participation by small businesses and DVBEs. As a result, decision makers do not have adequate information to determine the true cost and benefit to the State of strategic sourcing.

State law requires that small businesses and DVBEs must perform commercially useful functions in providing goods or services that contribute to the fulfillment of a state contract. Such requirements are designed to ensure that the firms play a meaningful role in any contract in which they participate. When awarding contracts, General Services primarily relies on attestations by the firms that they will meet these requirements. Further, it does not monitor small business and DVBE subcontractors to ensure that they comply once the contract has been awarded. That General Services does not verify the intended functions of each subcontractor before the award of the contract is reasonable, as these intentions represent a plan that has not yet been enacted. However, we believe General Services should verify, for a sample of contracts, that subcontractors are performing commercially useful functions after the contracts are awarded. This is especially important because questions have been raised about the roles of small businesses and DVBEs involved in one of General Services' contracts. We believe the contract raises policy questions about the use of subcontractors that the Legislature may want to consider further.

Although General Services has a new automated process to monitor whether contractors are complying with contract pricing terms, it does not have standard procedures to recover any overcharges identified. Additionally, General Services relies on contractors to provide the data related to the quantity purchased by state agencies and the prices they paid without verifying that the data are accurate, so it cannot be assured that its efforts to ensure pricing compliance are meaningful. General Services believes individual state agencies making the purchases are responsible for ensuring that contractors charge them correct amounts. However, discrepancies identified by General Services' new compliance process demonstrate that state agencies are not always performing this task effectively.

RECOMMENDATIONS

To ensure that it determines the savings to the State going forward for strategically sourced contracts, General Services should examine recent purchasing patterns when determining whether to rebid or extend previously strategically sourced contracts and when estimating expected savings. It should compare the savings it achieves to the expected savings for those contracts. Also, to ensure that it maximizes the savings for CGI-recommended categories that it did not strategically source, General Services should conduct its planned review of these categories to determine if there are further opportunities to achieve savings.

To ensure that it maximizes savings to the State for future purchases, General Services should follow the procedures for identifying strategic sourcing opportunities included in the IAU's procedures manual. To ensure that it is identifying new strategic sourcing opportunities effectively, General Services should work to obtain comprehensive and accurate data on the specific items that state agencies are purchasing. 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. General Services should assess any need for additional resources based on the savings it expects to achieve.

To determine the true cost and benefit of strategic sourcing, General Services should evaluate any impact strategic sourcing has on small business and DVBE participation in terms of number of contracts awarded and amount paid to small businesses and DVBEs within the categories being strategically sourced.

To ensure that small business and DVBE subcontractors comply with the commercially useful functions requirements, General Services should monitor, on a sample basis, their compliance with these requirements after a contract has been awarded.

To ensure prompt recovery of state funds, General Services should implement standard procedures to recover any overcharges to state agencies identified through its review of pricing compliance. Also, to improve the integrity of its monitoring of pricing compliance, General Services should implement procedures to help ensure that usage reports reflect the actual goods received and prices paid by the state agencies that purchase items.

Finally, to provide further clarity regarding the use of small business and DVBE subcontractors on state contracts, the Legislature should consider the policy questions we raise in this report and revise state law as it deems appropriate.

AGENCY COMMENTS

General Services stated that it is fully committed to promptly and completely addressing the issues identified in the audit report. It outlined the actions it will take or has begun taking to address each recommendation.

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