

Office of the County Internal Performance Auditor

Promoting Government Accountability While Providing Fair and Objective Oversight, Insight, and Foresight into County Government Operations



Hillsborough County Board of
County Commissioners

SUMMARY REPORT 10-01

Date: April 23, 2010 **ACTION REQUIRED**

To: Mr. Ken Hagan, Chairman,
All Hillsborough Board of County Commissioners (BOCC or Board)

CC: Mr. Mike Merrill, Acting County Administrator
Mr. Don Odom, Acting County attorney
Mr. Eric Johnson, Management Services Administrator
Mr. Tom Fesler, Acting Director, Department of Procurement Services

From: Mr. Jim Barnes, County Internal Performance Auditor (IPA)

Subject: Review of Office Depot Office Supplies Contract and Pricing

This purpose of this Summary Report is to inform you of the results of our preliminary and cursory review of Hillsborough County's purchase of office supplies from Office Depot (OD). Our review and analysis was authorized by the Board at its December 16, 2009, meeting. Based on Board direction, our objectives were to interview and question the "whistleblower" and to determine

- 1) if OD complied with pricing terms as authorized and stated in the applicable OD office supplies contract.
- 2) whether or not OD applied the right pricing formulas to products sold to Hillsborough County (County or HC).
- 3) whether or not a more detailed audit is warranted.

It is our conclusion that the OD office supplies contract used by the County is not in its "best interest." This conclusion is supported by the following confirmed facts:

- The contract is not administered or monitored by the State of Florida (SOF) contract administrator or the County's procurement services department.
- The SOF contract administrator does not have access to information allowing verification of contract prices.
- The published prices for supply purchases were not established in accordance with the authorized contract.
- OD would not provide cost data and other supporting documentation to support the prices of its products sold to the County and subsequently billed during the review period. Providing data to the customer for internal control purposes is required by the attachment to the SOF/OD contract, vis-à-vis, the "Authorized Contract."
- OD did not properly differentiate product categories and pricing methods.

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- OD did not honor prices in accordance with the “most favored public entity” clause of the contract which acts as a “low-price guarantee.”
- Toner and ink cartridge products for printers and fax machines can be procured more economically from other supply sources. These products comprise the largest dollar purchases by county departments and employees.

Based on our preliminary and limited review of usage data (purchases) for the period July – December 2008, and the pricing structure and arrangement identified in the Authorized Contract, OD may have overcharged HC as much as \$200,000 for office supplies purchased during the 6-month period, and as much as \$1.0 million since February 2007.

These estimated overcharges are preliminary based on detailed analyses of the contract pricing plans/formulae and published OD office supply catalogs but require further audit to establish a true dollar amount for overcharges. In lieu of cost data, and absent any information challenging our assumptions, we determined and recalculated the correct product prices by applying discount-off list percentages identified in the Authorized Contract (or other government contracts or OD retail operations) to office products sold to the County.

The following events also lead us to believe that OD pricing and billing practices are suspect:

- An investigation/audit completed in December 2009 by the City of San Francisco (California) Auditor found overcharges of \$5.75 million on an \$18 million contract.
- On January 26, 2010, the Lee County (Florida) School District terminated its relationship with OD after accepting a refund check for \$297,063.¹
- Following an audit completed in October 2009, the City of Clearwater (Florida) Auditor reported overcharges of \$166,000.
- An audit by the City of Ft Lauderdale (Florida) Auditor issued in December 2009 found that OD resorted to questionable contract practices creating a disadvantage and overcharges to the City in procuring office supplies.
- In May 2009 City Of Los Angeles (California) Auditor reported that \$2.6 million in non-catalog purchases were not given guaranteed low prices.
- The Florida State Attorney is investigating OD pricing irregularities.

OD does not have a “gag” or restraining order preventing the whistleblower from talking with auditors or disclosing information to us based on his work experience as sales manager with OD. Our review attempted to verify and substantiate claims he has publicly made or asserted. Because the usage data provided by OD is public information, we shared that data with the whistleblower and an industry expert for clarification purposes only. They, along with State of Florida (SOF) representatives and other governmental audit organizations, provided pricing information that we could not obtain otherwise from OD.

Contracting for Office Supplies

HC does not have a contract with OD but “piggybacks” on a SOF contract in accordance with Florida statute and Board policy. By Board Procurement Policy, the HC Department of Procurement Services (DPS) must make a determination that using a third party contract is in the best interest of the County. Per Paragraph IV-B of this Policy, solicitations of bids do “not

¹ Lee County School Board used the Los Angeles County, California, version of the OD supply contract, not the SOF modified version. Lee County audit findings and claims were made as a result of “bait and switch” tactics employed by OD. The Florida ACS does not provide for options.

apply to purchases established under Florida Chapter 69-1119² Laws of Florida, State of Florida Contracts...**Purchases of any amount may be made by the Administrator against those contracts provided they are in the best interest of the County.**” (Emphasis added.) We did not find any DPS assessments or determinations that concluded the SOF/OD office supplies contract was “in the best interest of the County.” DPS did not notify the Board of the use of the SOF/OD office supplies contract because the Board policy allows the County Administrator (and the DPS) blanket authority to use this type of contract.

The office and school supplies contract between the SOF and Office Depot 618-001-07 Alternate Contract Source (ACS), as amended, is an agreement authorizing and guiding use of U.S. Communities (USC)³ National Cooperative Contract 42595,⁴ a competitively solicited and awarded office supplies contract by Los Angeles (LA) County, California, with OD. The LA County contract prohibited the purchase of certain OD catalog items: “County departments are not authorized to use this agreement as a purchasing source for products not specifically covered herein.” This prohibition is not addressed or modified in the ACS.

The ACS identified the LA County/OD contract as the “Authorized Contract” (AC) and included it as Exhibit A. The effective dates of the ACS were January 29, 2007, to January 1, 2011. The SOF Department of Management Services (DMS) administers the ACS. HC is an authorized user of the contract per Section A “Scope” and, as such, “may make purchases from this ACS Agreement pursuant to the terms and conditions of the AC as modified and supplemented herein.” The ACS indicated that the LA County/OD Contract was cost effective and in the best interest of the SOF and other eligible users of it.

Contract Administration and Monitoring Issues

We found significant control weaknesses in procuring, administering, managing, and monitoring the ACS that contributed to the potential overcharges we found. DMS has employed four (4) different contract administrators for the ACS contract since January 2007. Following an audit, the DMS Inspector General (IG) reported in August 2008 that DMS “does not administer the (Office Depot) contract...does not have access to the data and information necessary to assess whether pricescomply with the contract provisions.” The IG report further stated that DMS “is not able to adequately monitor and enforce the vendor’s compliance with contract provisions on the state’s behalf.” In our opinion, if DMS cannot provide assurance on the state’s behalf, then it cannot provide similar assurances to those local Florida governmental agencies using the ACS. DPS and the County rely solely on DMS to administer and monitor the contracts into which it enters.

In his report on OD purchases issued in March 2009 (Report # 178), the HC Clerk Auditor reported concerns related to the ACS contract:

The responsibility for managing a “Homeless”⁵ contract needs to be assigned

² We could not locate a copy of this Florida law or its amendments.

³ Per their website, the U.S. Communities™ Government Purchasing Alliance is a “nonprofit government purchasing cooperative that assists local and state government agencies, school districts (k-12), higher education, and nonprofits in reducing the cost of purchased goods through pooling the purchasing power of public agencies nationwide.”

⁴ Contract 42595 is provided at the U.S. Communities’ website but it is an incomplete document, omitting provisions and exhibits of the contract, especially the pricing structure. We obtained a complete copy from an independent source.

⁵ “Homeless” was defined by the Clerk Auditor as a “contract used by many departments.”

to a specific group or individual... Good contract monitoring procedures include clearly defined, well understood objectives and responsibilities that are assigned for accountability and reporting to properly trained, skilled, and knowledgeable personnel.

The Clerk Auditor also identified reasons for monitoring vendor performance:

- to “ensure compliance with the terms and conditions in the contract;” and
- to “monitor prices charged by OD against the State’s contract prices and other pricing sources.”

The County’s reliance on DMS for contract administration creates high levels of risk and severely inhibits

- (1) protecting County resources against waste, fraud, and inefficiency;
- (2) ensuring stakeholders of accuracy and reliability in accounting and operating data;
- (3) securing compliance with the contract; and
- (4) evaluating the level of performance of the vendor/contractor.

Further exacerbating the risk: the national organization endorsing the use of the OD contract receives a significant residual stipend from OD for that endorsement. USC received 1% to 2.5% of OD sales as an administrative fee to fund its operating expenses and offset its costs. This amounted to over \$6.0 million annually. This arrangement creates potential conflicting interests with something less than an arms-length arrangement with the vendor; it could be perceived as inhibiting USC from effectively monitoring the OD contract provisions.

Advantages and Disadvantages of the ACS Contract

The ACS contract was identified and touted as an alternate or modified version of the LA County contract. Per DMS representatives, the major differences in the two supply contracts were the ACS offered

- 1) an expanded “core”⁶ product list; and
- 2) deeper discounts and lower prices in lieu of 6% incentive discounts.

However, we did not find in ACS Section B “Changes and Additions to the Authorized Contract” any modifications or stipulations regarding the pricing structure identified in Exhibit A of the Authorized Contract; the ACS did not include a unique pricing structure/arrangement different from the AC or identify the extent of additional discounts over and above the 45% and 70% indicated in the AC. We could not locate any contract references to core product lists or other pricing categories, methods, and discounts identified in Exhibit A. Too, terms and conditions in the AC were not amended to be Florida-specific, thereby allowing OD to assert that certain provisions are subject to various interpretations and non-binding.

References to LA County were not re-defined or substituted in the ACS. The LA County contract specifically excluded the following items:

- 1) Paper for copiers and printers
- 2) Computer and computer peripherals
- 3) Photocopiers
- 4) Toner products
- 5) Cameras, film, and accessories
- 6) Janitorial products
- 7) Food items

⁶Although not defined in any contract or other related information, “core” products are those in high demand and frequently used by the customer.

- 8) Refrigerators
- 9) Audio-visual items
- 10) Furniture
- 11) Classroom supplies
- 12) Arts and crafts

The LA County contract specifically noted that “County departments are not authorized to use this agreement as a purchasing source of products not specifically covered herein. Changes of items, equipment, or modifications to prices, specifications or conditions, etc., of this agreement can be made only by the Purchasing agent by issuance of official amendment and in accordance with properly authorized changes agreed upon prior to consummation.....LA County will not pay for items not listed below that have not been processed in accordance with the above paragraph. Vendor will incur payment problems.” The LA County Contract also referenced Exhibit A as containing a “core list of items and pricing.” As can be seen in the Attachment (Exhibit A), there are no lists of core products.

By including major provisions and attachments to a third-party contract, the structure of the ACS contract is convoluted and flawed in that it incorporates a third-party (LA County) contract that employs and combines multiple and confusing pricing categories, sources, and methods: core and non-core; supplier and wholesale catalogs; fixed, discount-off list, and cost-plus pricing. Definitions or clarifications of these terms were not included as part of the contract. In our opinion, the contract is constructed whereby only OD or an industry expert could interpret its terms and terminology, a distinct disadvantage to anyone responsible for managing and monitoring it at the local level, especially when the contract was initiated and awarded by a third-party with its own self-interest.⁷

The expanded core list has advantages only when the customer purchases those items on a regular basis. Our review showed that core products represented a very small percentage of total available office products, were brand-oriented, and included a number of toner products that were discontinued or not available. With the exception of toner products, core items were heavily discounted, usually more than 70%. Core products were not specifically identified in any vendor catalogs. Without a special designation, customers would not know which products were heavily discounted from the retail prices shown in the catalogs.

While core items represented about one-third of total items purchased, the percentage of dollars spent on core items represented only 7% of the total dollars spent.

Net Purchases of Office Supplies from OD July – December 2008

Product Category	Net Purchases	Net Dollar Amount
Core	29,190	\$54,524
Non-Core*	61,288	\$715,314
Totals	90,478	\$769,838

* Includes all products/items not listed on SOF core list.

Source: Office Depot Usage Report: 7/08 - 12/08.

⁷ LA County did not negotiate the terms and conditions of the contract with the intent or purpose that it would be adopted and used by other governmental jurisdictions

County Purchases Using the ACS Contract

According to information provided by OD, the County purchased approximately \$1.45 million in office and related supplies in calendar year 2008, \$4.07 million between February 2007 and December 2009. Based on an unaudited and unverified usage report prepared by OD, net purchases totaled \$769,838 for the period July – December 2008. HC received discounts ranging from 0% to 95% on these purchases. Included in this amount was \$315,000 for toner/ink cartridge products.

We understand the complexities and nuances involved in understanding and performing an analysis to assure appropriate contract billing. OD's failure to provide the necessary pricing data used for billing purposes greatly extended the time necessary to complete our review of the accuracy of those billings. It is OD's responsibility, not the auditor's, to provide the supporting documentation necessary to justify its prices and billings.

Similarly, based on the very limited data provided by OD in the HC usage report, we could not verify the accuracy, appropriateness, and application of the "discount-off list" prices for non-core items. We employed a self-styled approach and methodology to evaluate the pricing structure; a very time-consuming data entry process using various resources became necessary. Without OD's cooperation and assistance in providing the necessary data to properly assess the accuracy of billings, our findings and conclusions are based on the best available data and information. For purposes of this report, we assumed all products were either fixed price (core only) or discounted at 45% or 70% with all items from the "supplier," not "wholesale," catalog.

RECOMMENDATIONS

We recommend that

- The County immediately discontinue using the Florida office supply contract with OD and seek alternative office supplies sources that are readily available and in the best interest of the County, including appropriate determinations and effective contract monitoring. This can be done with minimum inconvenience or loss of service.
- A more detailed and comprehensive audit be conducted to determine the appropriate and correct prices for supply products furnished by Office Depot since February 2007. Once this audit is completed actions should be initiated to seek a full refund from OD for any overcharges and the cost of the audit. This detailed audit will require OD to provide cost data in support of prices established using the cost-plus method. If not, alternative methods for determining appropriate pricing, such as we used, will be necessary
- Serious consideration be given to permanently disbaring Office Depot from providing its services to HC for failing to abide by contract provisions and terms.
- A detailed and comprehensive audit be performed of the County's procurement policies and practices regarding the use of 3rd party contracts, including SOF contracts, and determinations that such contracts are in the best interest of the County.

Attachment