

OFFICE OF
CONTROLLER

200 N. MAIN STREET, RM 300
LOS ANGELES 90012
(213) 978-7200
www.lacity.org/ctr

May 20, 2009

Honorable Antonio R. Villaraigosa, Mayor
Honorable Rockard J. Delgadillo, City Attorney
Honorable Members of the City Council
c/o City Clerk's Office

**SUBJECT: REVIEW OF CITY'S CONTRACT WITH OFFICE DEPOT FOR THE
PURCHASE OF OFFICE SUPPLIES**

I am releasing the enclosed report titled "Review of the City's Contract with Office Depot Business Services Division for the Purchase of Office Supplies". A copy of this report was provided to the Department of General Services.

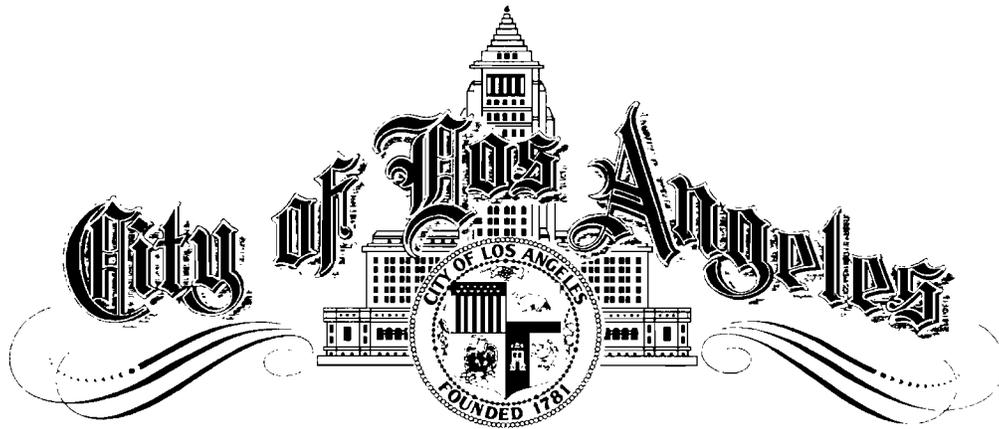
If you have any questions or comments, please contact Farid Saffar, Director of Auditing, at (213) 978-7392.

Sincerely,

A handwritten signature in black ink, appearing to read 'Rushmore D. Cervantes', is written over a large, faint, stylized watermark of the signature.

RUSHMORE D. CERVANTES
Acting City Controller

Enclosure



OFFICE OF
CONTROLLER

200 N. MAIN STREET, RM 300
LOS ANGELES 90012
(213) 978-7200
www.lacity.org/ctr

May 20, 2009

Mr. Tony M. Royster, GM and City Purchasing Agent
Department of General Services
701 City Hall South
Los Angeles, CA 90012

Dear Mr. Royster:

Enclosed is a report titled "Review of the City's Contract with Office Depot Business Services Division for the Purchase of Office Supplies". A draft of this report was provided to you on April 10, 2009 and discussed at an exit conference with your staff on April 28, 2009. We considered your Office's comments prior to finalizing this report.

Please review the final report and advise the Controller's office by June 22, 2009 on planned actions you will take to implement the recommendations addressed to your office. If you have any questions or comments, please contact me at (213) 978-7392.

Sincerely,

A handwritten signature in black ink, appearing to read 'Farid Saffar', written in a cursive style.

FARID SAFFAR, CPA
Director of Auditing

Enclosure

cc: Robin Kramer, Chief of Staff, Office of the Mayor
Jimmy Blackman, Deputy Chief of Staff, Office of the Mayor
Ben Ceja, Director, Finance & Performance Management, Office of the Mayor
Karen E. Kalfayan, Interim City Clerk
Gerry F. Miller, Chief Legislative Analyst
Independent City Auditors



City of Los Angeles Office of the Controller

Review of the City's Contract with Office Depot Business Services Division for the Purchase of Office Supplies

May 20, 2009

Rushmore D. Cervantes
Acting City Controller

TABLE OF CONTENTS

Executive Summary.....	1
Background and Methodology.....	2
Findings.....	4
#1: The City purchased \$2.6 million in products from unauthorized catalogs, at unfavorable discount pricing that was not disclosed to departmental users.....	4
#2: The City purchased at least \$123,000 in blocked items that were specifically prohibited by the contract.....	5
#3: The City purchased \$434,000 in Specialty and Manufacturer Direct Items with unfavorable discount pricing that was not disclosed to departmental users.....	6
Recommendations.....	6

REVIEW OF THE CITY'S CONTRACT WITH OFFICE DEPOT BUSINESS SERVICES DIVISION FOR THE PURCHASE OF OFFICE SUPPLIES

EXECUTIVE SUMMARY

The Controller's Office has completed a review of purchases made under the authority provided by the City's contract for office supplies with Office Depot Business Services Division (Office Depot). Contract No. 58540 was effective January 2, 2006 for a four-year term with annual purchases through 2008 exceeding \$6 million per year. The Department of General Services (GSD), Supply Services Division, is the contract administrator and has responsibility for setting the contract pricing and terms, and for monitoring the vendor's compliance with the contract.

The purpose of this review was to determine if Office Depot complied with the pricing terms for item purchases, as authorized and stated in the City's contract. We initiated this review, in part, due to publicized results of several state audits of government office supply contracts with Office Depot. During 2008, audit reports issued by the states of California, North Carolina, Nebraska and Georgia identified findings related to pricing discrepancies and sales of unauthorized items by Office Depot, as compared to the terms of their respective contracts.

Our review found that due to GSD's lack of oversight, the City's Office Depot contract did not include all applicable contract terms, and did not specify that many items were subject to less favorable discounts. GSD did not alert user departments of this fact, nor were these items identified at the time of their electronic procurement as potentially being more costly than the item's retail price or an alternative.

We estimate the City spent about \$2.6 million for items that were not included in the authorized catalogs listed by the contract which included favorable discounts. A random sample of these purchases revealed that the City paid an average of 12% higher than the retail price available to the general public. In addition, we found approximately \$434,000 in specialty or manufacturer-direct item purchases were charged at a lower discount rate than what was noted in the City contract. Also, an estimated \$123,000 in paper items specifically prohibited by the contract were sold to the City.

As the City's Purchasing Agent, GSD must ensure that contracts provide the most favorable pricing available and that departmental users have necessary information to make informed purchases. As a result of this review, in late January GSD reiterated to users what items are excluded from the contract, and executed contract amendments that validate the less favorable discount terms.

The remainder of this report provides additional information regarding the City's contract with Office Depot, review methodology and results, and recommendations.

BACKGROUND & METHODOLOGY

The City has had a contract with Office Depot to provide office supplies at discounted rates for a decade. The initial agreement was issued in 2001 as a cooperative purchasing arrangement, or “piggyback” onto a Los Angeles County Master Agreement. The City Administrative Code provides an exception to the competitive bidding requirement if the City enters into a cooperative purchasing contract with another governmental agency. GSD procurement staff determine if a cooperative purchasing option would benefit the City, and may initiate a City of Los Angeles contract in accordance with the government agency’s agreement. However, related terms and pricing must be referenced within the City contract, which may also specify exclusions or other clarifications that are specific to the City.

The City has since executed two additional contracts with Office Depot for purchasing office supplies. While both indicated they were replacements of a prior contract that was awarded in accordance with the County’s Master Agreement, GSD files do not include any specific “piggyback” authorization, indicating that the City’s current contract was issued in accordance with the County’s Master Agreement, or contain all terms and product pricing conditions contained therein.

While the County’s Master Agreement includes several attachments and alternative pricing methods, the City’s contract includes a specific listing of approved items, with applicable discount terms to each. Office Depot representatives confirmed that government clients who issue contracts in accordance with the Master Agreement are not required to adopt all terms of the agreement, or pricing structures.

Specific language included in all of the City’s contracts with Office Depot state that only listed items can be purchased under the contract. The contract also states that the City will not pay any invoice covering the delivery of any merchandise that is not explicitly authorized by the contract. Relevant information pertaining to listed items and terms noted in current and prior City and County contracts with Office Depot is presented as Attachments 1 and 2.

The City’s Contract No. 58540 with Office Depot

As specified in the original contract, the listing of approved items is found in four Office Depot and U.S. Communities catalogs and one core product list:

- Everyday Office Essentials Catalog (updated semi-annually)
- U.S. Communities – Core List (updated annually)
- Business Supply Source Catalog (updated semi-annually)
- U.S. Communities Green Book Catalog (updated semi-annually)
- Business Services Division Hon Office Furniture and Global Total Office Catalog (includes Office Furniture items from manufacturers, updated semi-annually)

In addition, the contract excluded 17 types of items from purchase under this contract, even though these may be listed in the catalogs noted above. Excluded item categories include computers, cameras, paper, photocopiers, printers, etc. The primary reason for excluding these items from the Office Depot contract is because the City has other vendor contracts that cover these items.

In January 2006 when contract No. 58540 became effective, GSD issued an electronic newsletter to user departments announcing the contract and noting that the City Purchasing Agent was able to obtain increased discounts as reflected in the new contract.

The majority of City departments utilize e-procurement to initiate purchases from Office Depot. Authorized purchasers have a unique Office Depot customer account number which they use to log into a web-based portal displaying available items for purchase. Office Depot tracks orders placed by account holders. Departments that do not have e-procurement have access to the same web-based Office Depot portal, but their orders are not directly connected to the City's Supply Management System (SMS). Office Depot is responsible for blocking the contract-excluded items from the web-portal, to prohibit them from being purchased by the City.

Departmental purchasing agents who utilize e-procurement can conduct a search of available items and are alerted of the "Best Value" if one exists. However, e-procurement does not alert the user with information about the respective item having come from a particular catalog, or the actual discount terms that have been applied.

Office Depot is mandated by the contract to provide a monthly "usage report" listing all items purchased by the City under the contract. The usage report lists a description of the item, price paid, and the item's unique SKU number. Each catalog referenced by the contract also lists products by description and SKU number, with the exception of the Business Services Division Catalog for Hon Office Furniture and Global Total Office, since their identifying SKU numbers are assigned by other business entities.

Scope and Methodology

Controller staff requested Office Depot to provide a contract usage report along with an automated download of each current catalog applicable to the City's contract. Office Depot provided downloads for the four supplier catalogs and core product list.

The usage report provided by Office Depot was compared to each supplier catalog and core list in effect for the period July 1, 2008 through August 31, 2008. Using automated audit software, items included in the usage report were matched by SKU number against the supplier catalog items. Controller staff relied on the data provided by Office Depot as an accurate reporting of purchases made under the contract.

We excluded all Hon and Global Total Office furniture catalog items and purchases made by LAWA and CRA (which appeared on the usage report but utilize a different

contract purchasing authority) to determine the number of unauthorized, non-supplier catalog items purchased.

We also reviewed City purchases as recorded in SMS since the contract's inception in January 2006. Total City purchases under the Office Depot Supply Services Contract include:

<u>Year</u>	<u>Amount</u>
2006	\$6,727,421
2007	\$6,665,302
2008	\$6,770,385

The City has purchased a comparable amount under this contract for each of the last three years. Since contract purchase volume has remained consistent, and the terms of the contract did not change, the analysis performed for the months July and August of 2008 could be indicative of activity over the entire contract period. In the absence of having access to historical catalogs listings and detailed sales information covering the entire contract period (which was requested by not provided by Office Depot), the findings of this review were projected over the period in which the contract terms were effective.

FINDINGS & RECOMMENDATIONS

GSD issued Contract No. 58540 that included an explicit listing of authorized supplier catalogs and their respective discount terms. In an electronic newsletter sent to departmental users, GSD stated that they were able to obtain increased discounts as reflected in the new contract, effective January 2006. However, neither the contract nor further communication with users gave an indication that many items would be charged at less favorable discount rates. In addition, neither GSD nor Office Depot adequately blocked all purchases that were prohibited by this contract. Key findings include the following:

The City purchased \$2.6 million in products from unauthorized catalogs, at unfavorable discount pricing that was not disclosed to departmental users.

Our analysis found that over the two month period, the number of unauthorized, non-supplier catalog purchases totaled 1,914 items in the amount of \$143,816. We confirmed that the majority¹ of these items were priced at "10% off manufacturer's list price".

GSD asserted that these items were authorized for purchase since all terms of the County's Master Agreement applied to the City Contract, and they were included in wholesale/special order catalogs, which are referenced by the County's Master Agreement at the stated "10% off list" discount price. However, wholesale/special order

¹ We were unable to determine the classification for items totaling \$33,384, since they were not listed in supplier catalogs and noted a pricing structure other than the "10% off list".

catalogs were not explicitly listed in contract No. 58540 and were not provided to us by Office Depot at the time of our review. GSD stated it was their intent for the City's contract to allow for all items and terms that were included in the County's Master Agreement. Once this issue was brought to GSD's attention, the contract was revised through Amendment No. 9, which added line 3 to the contract, which includes the additional inclusion of an *Office Depot Wholesale Catalog AKA "Special Order Book" at list less 10%* to justify these purchases.

The contract had existed for a total of 37 months as of January 30, 2009, when Amendment No. 9 was effected. Therefore, the projected amount of sales to the City for unauthorized items not included in a listed catalog is estimated to be \$2.6 million over the contract period.

In addition, from a computer-generated random sample of 100 items purchased by the City that received the "10% off manufacturer's list price," we compared the price paid by the City to the price available to the general public, per the current retail price listed for that product, by SKU number, on Office Depot's consumer website. We found the City paid an average of 12% more than the retail price for these items. Therefore, for the estimated \$2.6 million of items purchased at the "wholesale" rate, the City may have paid even higher than retail prices.

Subsequent to the inclusion of Amendment No. 9, Office Depot announced that it was amending the County's Master Agreement by eliminating all current pricing and discount schedules in lieu of a single consolidated pricing schedule and single catalog. The amendment calls for fixed pricing on all items listed in their Business Solutions Big Book Catalog, which also contains a list of core items. On April 3, 2009, GSD incorporated this change as Amendment No. 10.

Although the amendment to the County's Master Agreement also lists discount rates applicable to non-catalog items, GSD did not adopt this portion of the amendment; therefore, non-catalog items are not allowed under the contract. As confirmed by GSD, the City's current contract (April 2009) is more limited than the County's Master Agreement; therefore, items not included in the "Big Book" at stated fixed prices must **not** be procured through this contract.

The City purchased at least \$123,000 in blocked items that were specifically prohibited by the contract.

Our review also identified sales of items that were supposed to be blocked by Office Depot. The usage report provided by Office Depot specifically identifies paper sales by an internal account number. The remaining contract-excluded items were not easily identifiable.

Based on the usage report and excluding purchases made by LAWA and CRA during an eight-month period from January 1, 2008 through August 31, 2008, there were 1,236

paper orders placed with Office Depot for a total of \$46,872. This equates to a monthly average of \$5,859.

Though the contract under review expressly excludes paper, Office Depot had a separate City paper contract (Contract No. 57778) until March 31, 2007. Therefore, the projected amount of contract-prohibited paper sales is estimated to be \$123,000 over the 21-month time period from April 1, 2007 through December 31, 2008.

The City purchased \$434,000 in Specialty and Manufacturer Direct Items with unfavorable discount pricing that was not disclosed to departmental users.

Contract No. 58540 did not make an explicit reference to supplier catalog items marked as S or M, nor did it indicate that these items would be priced at the wholesale rate of "10% off list."

For the two-month sample period of July through August 2008, we noted 604 items marked M or S were purchased at a discount rate of 10% off list, totaling \$25,929. This equates to a monthly average of \$12,964, or a projected amount of \$434,000 through October 17, 2008. These items received a lower discount than what was explicitly noted by the City contract.

After bringing this matter to the attention of GSD during our audit, on October 17, 2008 GSD issued a contract amendment indicating the exception to pricing instructions for items in supplier catalogs that were marked M and S as being 10% off list to justify these purchases.

It is also questionable whether these items were actually priced above the general retail price, as the following example illustrates.

We noted one instance during 2006 when a City department attempted to order an item that had been classified as "specialty" under e-procurement, for a City price of \$1,266. However, the departmental purchasing agent found the same item listed at \$799 in the general web catalog, available to the public. Office Depot ultimately adjusted the City's price to \$733, citing an error in their product classification

Because departmental purchasing agents are not alerted when a desired item is considered Specialty or Manufacturer-direct, and is therefore subject to less favorable discount terms than other supplier catalog or in-stock items, they lack information necessary to make an informed purchasing decision.

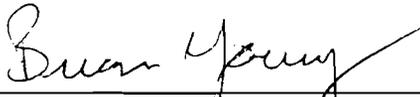
Recommendations:

As the City's Purchasing Agent, GSD is responsible to ensure that contracts provide the City with the most favorable pricing, and that vendors comply with contract terms. GSD must also provide complete and correct information to departmental users so they can make informed purchasing decisions. This was not the case for the Office Depot

contract. Instead, GSD's recently executed Amendments Nos. 8 and 9 validated the less favorable discount terms for many items sold to the City. Subsequent to those amendments Office Depot initiated a new Master Agreement amendment to eliminate all previously issued pricing and discount options in lieu of a single consolidated pricing schedule and single catalog, which has also been adopted through Amendment No. 10 by GSD. Therefore, we recommend that GSD:

1. Ensure that City department users/purchasing agents are provided with adequate disclosure of contract terms and revisions.
2. Ensure that only BSD Big Book listed catalog items are purchased under the contract.
3. Require Office Depot to take additional actions to ensure that contract excluded items are blocked from purchase, and to only sell items that are authorized by the contract.
4. Require that Office Depot include the City's CPO information or invoice number on their monthly usage report, in order to have a common identifier with SMS and facilitate appropriate compliance monitoring.

Respectfully submitted,



Brian Young, CPA, CFE
Special Investigator II



Siri A. Khalsa, CPA
Deputy Director of Auditing



Farid Saffar, CPA
Director of Auditing

April 30, 2009

City's Contracts with Office Depot

Contract	Term	Maximum	Reference	Listed Items*
57611	4/1/01 - 5/1/05	\$ 19,100,000	"You are hereby notified of the award of this contract with the City of Los Angeles in accordance with the National Association of Counties cooperative purchasing program and the County of Los Angeles Master Agreement No. 41421 for items thereof."	1. Office Supplies, high use/bulk items, from 2001 Office Depot Frequently Ordered products; discounts allowed from Vendor's nationally published price list/catalog. Preferred catalog. 2. Office Supplies, non-high use catalog, secondary catalog for items not found in Item 1. 45% discount allowed the City. 3. through 44. - specific items with set prices for each. Exclusions include 18 listed types of products, including "any item that is covered by another City supply contract"
58426	5/1/05 - 1/1/06	\$ 7,000,000	"This contract is a replacement of Contract No. 57611 that was awarded in accordance with the National Association of Counties cooperative purchasing program and the County of Los Angeles Master Agreement No. 41421".	Everyday Office Essentials catalog; 300 frequently ordered items at up to 80% off list; over 4,000 items at up to 63% off list. Business Supply Source Catalog (except products also appearing in the Everyday Office Essential Book) at 45% off list. Green Book items priced according to one of the above discount structures depending on the item. Business Services Division - Hon Office Furniture and Global Total Office - items priced at 45% off list. Exclusions include 18 listed types of products, including "any item that is covered by another City supply contract".
58540	1/2/06 - 1/1/10	\$ 40,000,000	"This contract is a replacement of Contract No. 58426 that was awarded in accordance with the National Association of Counties cooperative purchasing program and the County of Los Angeles Master Agreement No. 42595."	Everyday Office Essentials catalog; 500 core list items discounted up to 85% off list and over 4000 items at up to 70% off list. Business Supply Source Catalog (except products also appearing in Everyday Office Essential Book) at 45% off list. Green Book items are priced according to one of the above discount structures depending on the item. Business Services Division -Hon Office Furniture and Global Total Office - items priced at 45% off list. Exclusions include 18 listed types of products, including "any item that is covered by another City supply contract".
	10/17/2008		Amendment No. 8 signed noting the following comment: "Added Description to Line Item No. 1"	<i>Added the following language:</i> . . With exception of the following: Items marked in the catalog with a "S" (Special Product) --list less 10%; and Items marked in the catalog with a "M" (Manufacture Direct) --list less 10%.
	1/30/2009		Amendment No. 9 added line 3.	<i>Replaced all existing product and catalogs listed with the follow language:</i> Core Products Fixed Price; % discount up to 90% off list. "U.S. Communities Book" list less 70% "The Green Book" list less 70% Business Solutions Big Book; list less 45% with exception for items marked in the catalog with a "S" or "M" --list less 10%. Office Depot Wholesale Catalog AKA "Special Order Book" - list less 10%. Further notations of title/identification of catalogs. Explicit listing of contract exclusions, with notation of which relevant contract such items should be procured from.

***All three contracts contain the specific term "APPROVED CONTRACT ITEM PURCHASES: The listed items cover the only products approved for purchase under this contract".**

County's Master Agreements Office Depot

Contract	Term	Reference	Listed Items and pricing terms
41421	3/1/01 - 3/4/06	<i>Exhibit A:</i>	<p><i>Pricing, discounts and excludtions for Los Angeles County Only</i></p> <p>Applicable to all in-stock items shown in following catalogs: Core Products (Attach A) - fixed pricing as indicated Most Frequently Ordered Products Catalog - 63% off list Business Services Division Products Catalog - 45% off list Exclusions: Lists nine specific categories.</p>
		<i>Exhibit B:</i>	<p><i>Pricing for U.S. Communities Government Purchasing Alliance</i></p> <p>Applicable to all in-stock items shown in following catalogs, at cost plus pricing or discounts from Manufacturer's list price, or at the net prices as referenced in Attachments A (Core Products), B. Most Frequently Ordered Products Catalog - 63% off list Business Services Division Products Catalog - 45% off list Core List Exact (Attach B) - fixed prices as indicated Core List Alternate (Attach B-1) - fixed prices as indicated School Core Items (Attach B-2) - fixed prices as indicated Core Paper Items (Attach B-PPR) - fixed prices as indicated Recycled Core (Attach B-3) - fixed prices as indicated MWDVE Core (Attach B-4) - fixed prices as indicated MWDVA-APD Tier One Core (Attach B-5) - fixed prices as indicated</p>
42595	1/2/06 - 1/1/10	<i>Exhibit A:</i>	<p><i>All in-stock items shown in the Office Depot General Line Catalogs and United Business Products Catalogs shall be priced at the following:</i></p> <p>Toner: supplier catalog 45% off list; wholesale catalog 10% off list Furniture: supplier catalog 45% off list; wholesale catalog 10% off list Techonology products: supplier catalog - cost plus 17 gross margin; wholesale catalog - cost plus 25 gross margin; most frequently ordered items - cost plus 13 gross margin Paper products: supplier catalog - cost plus 17 gross margin; wholesale catalog - cost plus 25 gross margin; most frequently ordered items - cost plus 17 gross margin. Catalog products marked M and S - list less 10% Core Products - fixed price.</p>
		<i>Exhibit A-3</i>	<p><i>Alternate pricing option in place of Exhibit A. All items shown on the Office Depot website shall be priced at 10% less list.</i></p> <p>Toner; Furniture; General Office Supplies; Technology Products; and Paper Products, discount allowed both from website and wholesale catalog: web price less 10%. Core products - fixed price.</p>
		<i>Exhibit A-1</i>	<p><i>Pricing and Discounts for Classroom Supplies. All in-stock items shown in the Office Depot School Supply Book, S.P. Richards Business School Catalog and United Business Products shall be priced at the following:</i></p> <p>Classroom Supplies and Arts and Crafts: supplier catalog - 45% off list; wholesale catalog - 10% off list; most frequently ordered items - 70% off list. Paper products: supplier catalog - cost plus 17 gross margin; wholesale catalog - cost plus 25 gross margin Catalog Products marked M and S: 10% off list. Core products: fixed price.</p>
		<i>Exhibit A-4</i>	<p><i>Classroom Supplies Alternate Pricing Option. May be used in place of Exhibit A-1. All items shown on the Office Depot website shall be priced at 10% less list.</i></p> <p>Classroom supplies; arts and crafts; paper products, discount allowed both from website and wholesale catalog: web price less 10%. Core products: fixed price.</p>
		<i>Exhibit A-5</i>	<p><i>Additional Services</i></p> <p>Copy and Print Services: Retail - 15% Promotional Products: Promotional catalog less 5%.</p>