

1. BACKGROUND AND METHODOLOGY

Introduction

Purchasing is not simply buying--it is an essential activity necessary to acquire the resources to run the day-to-day operations of the government. Purchasing is a pervasive activity because the effectiveness of the program and the resulting level of quality of the goods and services purchased affects every aspect of the operations of the government. Many consider purchasing to be a routine and straightforward process. On the contrary, the purchasing process is very complex and the managers responsible must be skilled professionals to effectively administer the process.

In the State of North Carolina, purchasing includes a broader scope. It is the comprehensive program that includes planning the purchase of goods and services, the acquisition process, general oversight of inventory management, and the disposition of surplus property. For North Carolina, purchasing also includes the contracting of services.

Purchasing management alternatives

The design of state and local government purchasing systems varies greatly. State governments face a variety of choices in the way they manage their purchasing systems. Designing a state purchasing system is a process of making tradeoffs between flexibility and accountability. The following is a list of fundamental choices available to state governments in the way they manage purchasing:

Centralization versus decentralization

Typically, state governments have one central organization responsible for the management and oversight of all purchasing activities in the state. However, some purchasing decisions are "delegated" to the agencies. For example, although 49 states have a centralized purchasing office, many choose that select agencies remain autonomous.

Under these delegated conditions, states must also decide who is accountable and responsible for the oversight of the agencies. The State of North Carolina has a central purchasing authority--the Purchase and Contracts Division. However, oversight responsibility for the State agencies is currently unclear.

Standardization and specifications to aid in controlling purchasing

Detailing standards and specifications for commodities to be purchased can reduce costs and simplify purchasing for state agencies. This involves a central organization developing a standard of, or a specific design for, a given commodity; communicating the design to the state agencies; and all state agencies using that design when purchasing the product. The

State of North Carolina defines standards and specifications within the Purchase and Contracts Division for a variety of commodities.

Developing methods to increase competition

Competition in state purchasing is necessary to decrease costs and increase the quality of purchases made. However, state governments must develop purchasing policies to ensure competition occurs. Purchasing policy enhancements include:

- **Eliminating "buy-local" policies** - these policies require states to buy products from in-state vendors even if the price is higher than out-of-state competitors. When this occurs, it simply raises costs to the state and, in turn, the taxpayer. North Carolina does not have a buy-local policy. It does have a preference program that gives no real advantage other than giving business to an in-state vendor if he/she can match the price of an out-of-state vendor.
- **Eliminating restrictive specification** - any restrictive specification of a commodity that is not absolutely necessary should be removed. Restrictive specifications place unnecessary restrictions on a commodity that increase its price because of reduced competition. North Carolina has a policy against restrictive specifications.
- **Enhancing competition negotiations** - the purchasing policies should include using price and product quality as competitive factors. When deciding which product to buy, bids should be evaluated on price and quality. North Carolina purchasing policies require this sort of evaluation.

Cooperative purchasing

Cooperative purchasing involves arrangements between state and local governments to buy under the same contract. The benefit is that cooperative purchasing lowers the price by buying in quantity. North Carolina has cooperative purchasing agreements that are available to local governments and not-for-profits.

Planning and scheduling acquisitions

The concepts of planning and scheduling tend to overlap. Planning is concerned with how to best acquire goods and services and scheduling is concerned with when to acquire them. By planning for needs of all departments, a centralized purchasing activity can achieve significant savings through buying in larger quantities. The State of North Carolina achieves this by using term contracts for the purchase of commodities when large volume purchases are required.

Purchasing audit objective

The objective of a performance audit of a state purchasing system is to determine if the state's purchasing policies, procedures, and practices result in the state procuring quality goods and services in the most economical and efficient manner, at favorable prices, in accordance with state statutes and regulations and sound business practices. Inherent in this objective is a need to evaluate the state's policies and procedures to determine if improved or additional policies and procedures are needed to address the nature and range of the state's procurement activities.

Purchasing audit approach

Three principal approaches were used in evaluating the policies, procedures, and practices followed by the State in carrying out its purchasing activities.

First, we established a benchmark of the generally accepted purchasing practices as promulgated by the National Association of State Purchasing Officials. This organization has published a list of key elements or attributes of statutory, regulatory, and procedural characteristics of preferable procurement practices. Appendix A is a summary of these generally acceptable practices, compared with the policies and practices that our performance audit disclosed were in use in the State of North Carolina.

Second, in our review of the activities of the Purchase and Contracts Division and of selected agencies, we identified the policies and procedures issued by the Purchase and Contracts Division and each of the departments and agencies selected for review, and used these policies and procedures as a measurement to evaluate actual practices being followed.

In our analysis of the purchasing policies being followed by State agencies and departments, we obtained the latest completed self-assessment of the internal controls over purchasing and accounts payable cycles for each department and agency reviewed. This self-assessment is completed by the agencies and departments in response to a questionnaire prepared and distributed by the State Controller's Office.

Lastly, in our review of the State's purchasing practices, we identified the practices being followed by other governmental organizations and the private sector as a basis of comparison with the practices being followed by the State of North Carolina.

Audit scope

In our opinion, these three approaches provide a sound benchmark for an evaluation of the purchasing practices followed by the State of North Carolina.

The performance audit included a review of selected activities of the following agencies and departments:

- Purchase and Contracts Division, Department of Administration
- State Construction Office, Department of Administration
- Department of Human Resources
- Department of Environment, Health, and Natural Resources
- Department of Public Instruction
- Department of Transportation
- State Office of Correction Enterprises, Department of Correction
- University of North Carolina - Chapel Hill
- North Carolina State University
- Administrative Office of the Courts
- Administrative Division of the Legislative Branch

During the performance audit, Peat Marwick collected and reviewed a variety of information, some of which was compiled by agency staff. While the information provided by State agency personnel was reviewed for reasonableness and accuracy, it was not audited. Our performance audit was performed in accordance with Government Auditing Standards, issued by the Comptroller General of the United States.

2. THE CURRENT PURCHASING SITUATION

This section provides an overview of the State's current purchasing situation and the issues and challenges facing the State.

Introduction

The Department of Administration has overall responsibility for the State of North Carolina's program for the acquisition and management of property. The administration of the procurement function and activities is the responsibility of the State Purchasing Officer, who heads the Purchase and Contracts Division and reports to the Secretary of the Department of Administration.

North Carolina manages its purchasing functions in both a centralized and a decentralized manner. Departments within the State are delegated authority to procure supplies, equipment, materials, and services up to \$10,000, while the universities are generally delegated procurement authority up to \$25,000. The Purchase and Contracts Division advertises, reviews, and approves all purchases over this amount. The Purchase and Contracts Division also is responsible for awarding term contracts, which are used to establish suppliers and prices of commodities for purchase by State agencies for a specified period of time. When term contracts are established, their use by State agencies is mandatory.

State agencies are required to obtain authority to contract for consultant services from the Governor and the Division of Purchase and Contracts. State agencies contracting for consultant services in excess of \$10,000 are required to obtain approval for final determination of the successful contractor and award of the contract from the Division of Purchase and Contracts. Agency contracts for personal services are exempt from these requirements.

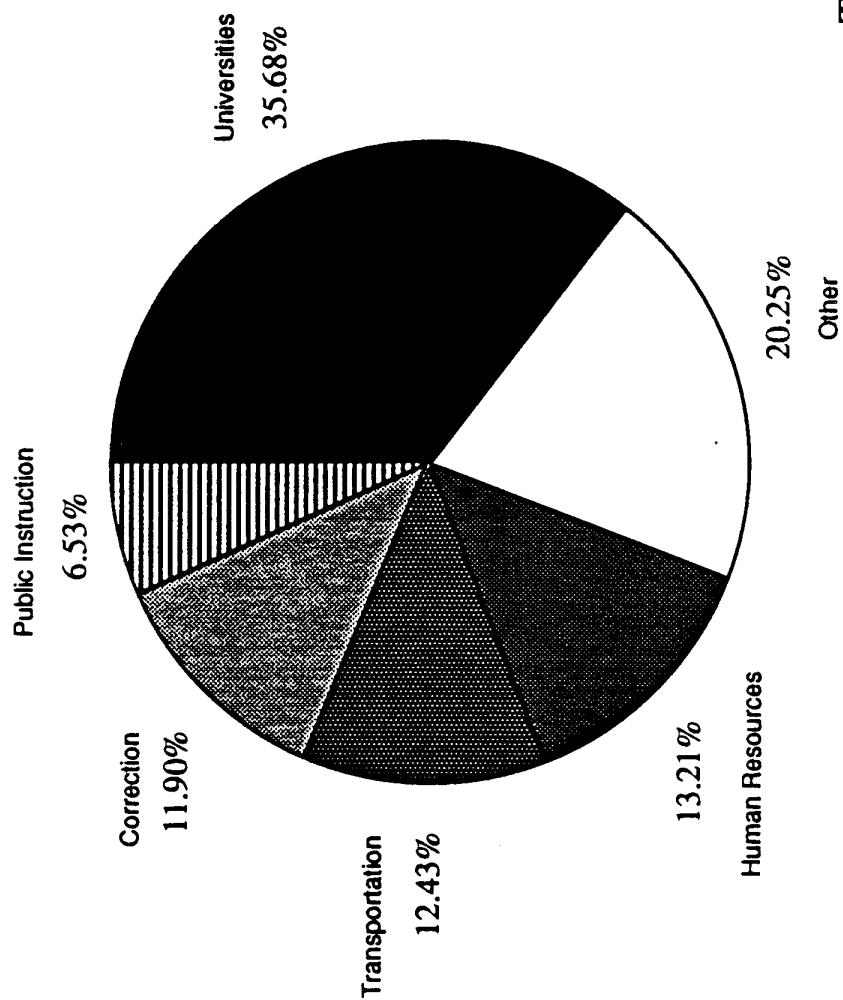
During fiscal year 1991, the State of North Carolina (excluding capital projects) expended approximately \$1 billion in the procurement of goods and services. Of this amount, the State universities expended by far the largest amount--\$364 million. The Department of Human Resources spent the second largest amount--\$134 million--for goods and services, while the Department of Transportation spent \$126 million. Exhibit 2-1 depicts the procurement dollars spent by department in fiscal year 1991.

The State of North Carolina is a major consumer of goods and services in the State. To understand the magnitude of these significant State purchases, the top five commodity purchases as estimated by the Purchase and Contracts Division are shown below:

Computer Hardware	\$85 million	Fuels	\$50 million
Vehicles	\$85 million	Furniture	\$25 million
Food	\$50 million		

These amounts represent purchases processed by the Purchase and Contracts Division and do not include purchases delegated to State departments and agencies.

Exhibit 2-1
Procurement Dollars by Department
Fiscal Year 1991



Total = \$1 Billion

Note: Procurement dollars exclude capital projects
Source: State of North Carolina Controller's Office

Methods of procurement

The State of North Carolina procures goods and services using a variety of methods. Because of the many types of procurements, and the elements of risk involved in each, North Carolina uses various levels of authorization and review for each method of procurement. These methods include the following:

Open market procurements

Open market procurements include the direct purchase of commodities and the procurement of services by State departments and agencies. The performance audit reviewed the use of open market procurement to understand how the orders are processed on the departmental level and within the Division of Purchase and Contracts, and the authorizations required at each level.

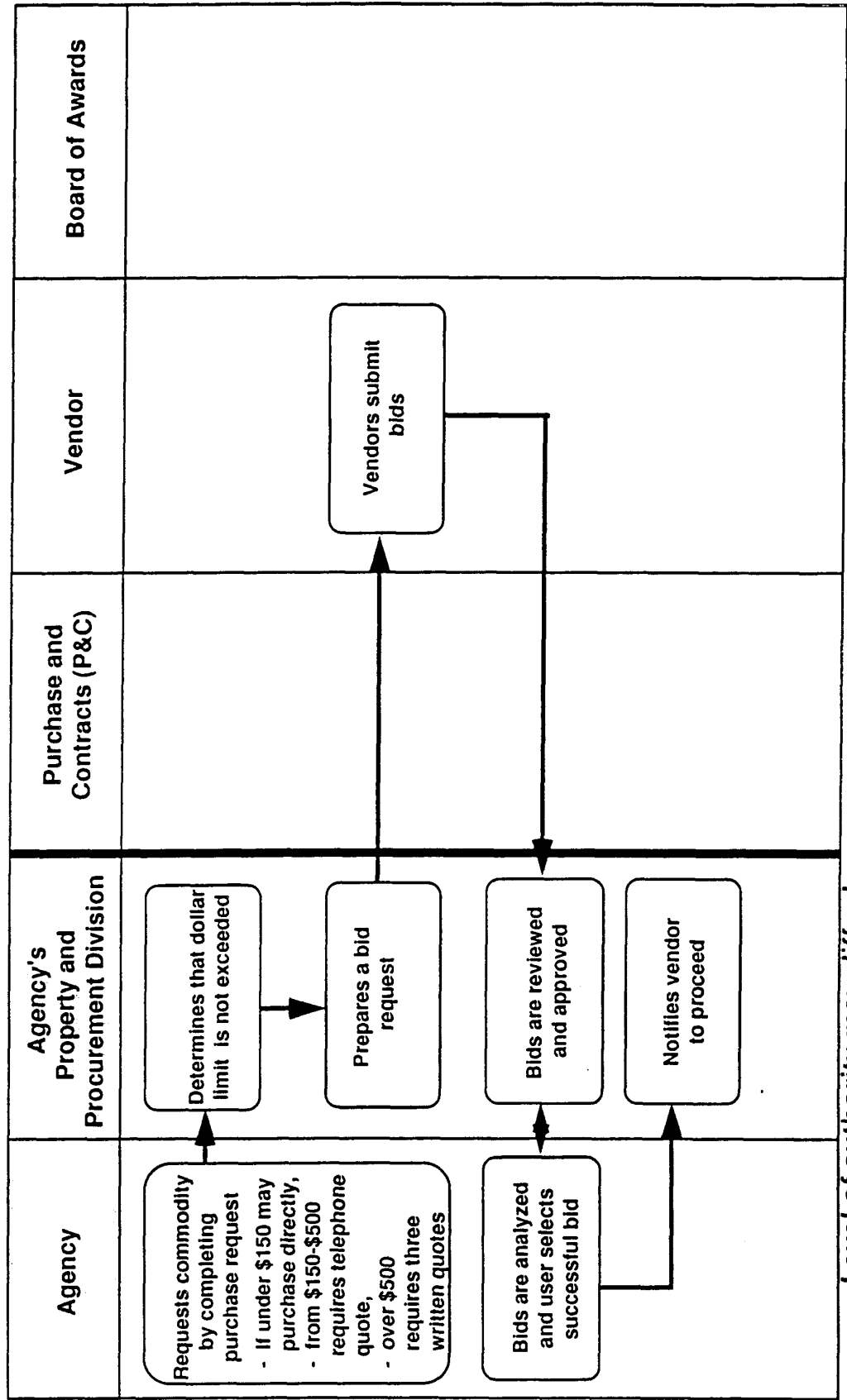
Under the State of North Carolina's policies and procedures, the Purchase and Contracts Division must review and approve all open market procurement of commodities and services over \$10,000 except for all but three of the universities, where review and approval is generally required at \$25,000. Exhibits 2-2, 2-3, and 2-4 illustrate the approval process for open market procurements.

Consulting contracts

The State of North Carolina defines a consulting contract as "services of an advisory nature and shall mean work or task(s) performed by State employees or independent contractors possessing specialized knowledge, experience, expertise and professional qualifications to investigate assigned problems or projects and to provide counsel, review, analysis or advice in formulating or implementing improvements in programs or services." In fiscal year 1991, consulting contracts of approximately \$12.5 million were awarded by the State of North Carolina.

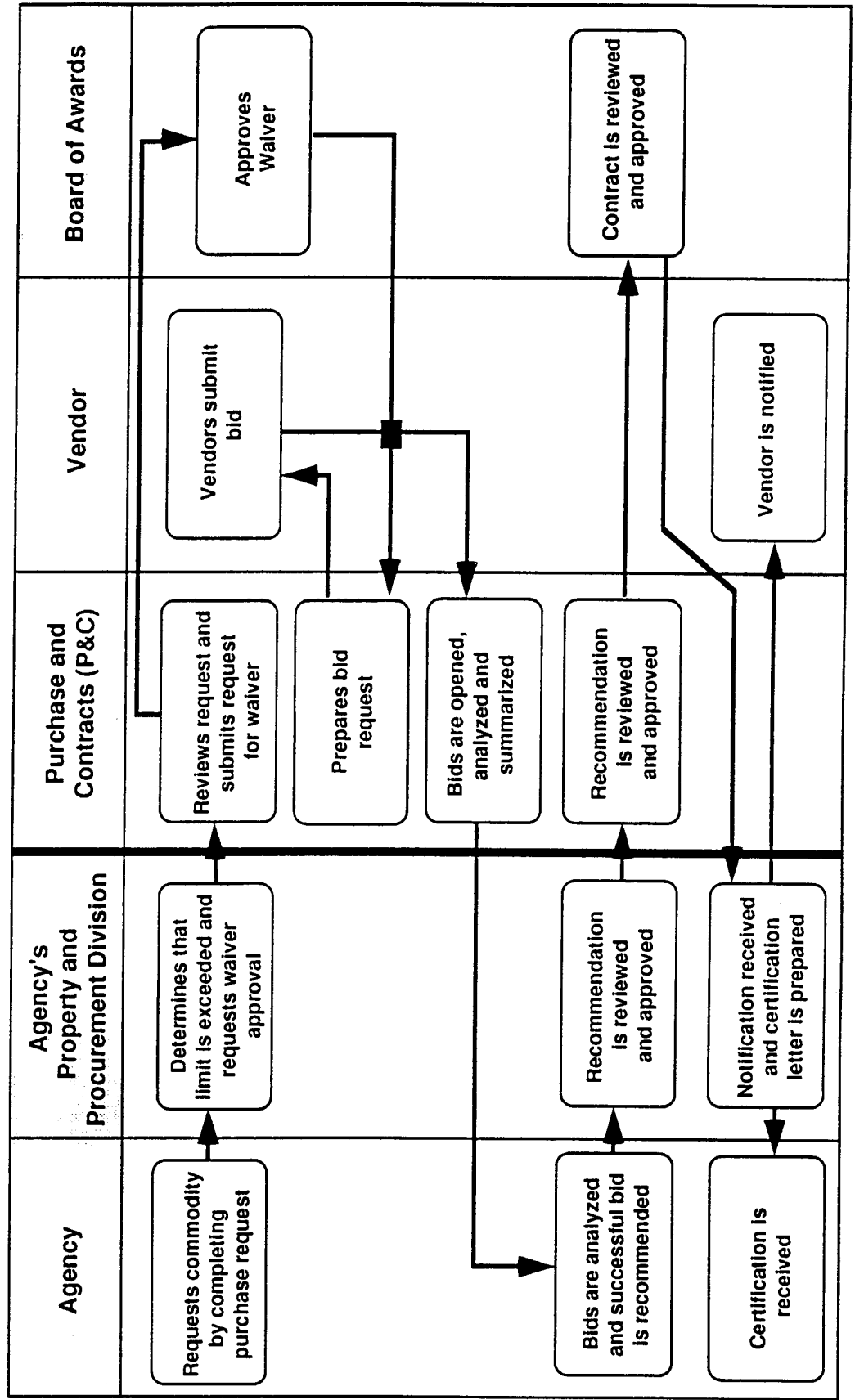
Awards of consulting contracts are a highly centralized process. The process begins when the agency writes a letter of justification for consulting services to the Purchase and Contracts Division, which, in turn, reviews the justification. The justification is then reviewed by the Governor's Office. Once a Request for Proposal (RFP) is developed, reviewed by the Purchase and Contracts Division, responded to by the vendor and the contract is to be awarded, the Governor's Office must again review and approve the contractor selection and award. Exhibit 2-5 illustrates the consulting contract approval process.

**Exhibit 2-2
North Carolina State Government
Purchase and Contracts Work Flows
Contracts Under \$10,000 (\$25,000 University)**



Level of authority may differ by agency

Exhibit 2-3 **North Carolina State Government** **Purchase and Contracts Work Flows** **Contracts Over \$10,000 (\$25,000 University)**



**Exhibit 2-4
North Carolina State Government
Purchase and Contracts Work Flows
Service Contracts over \$10,000**

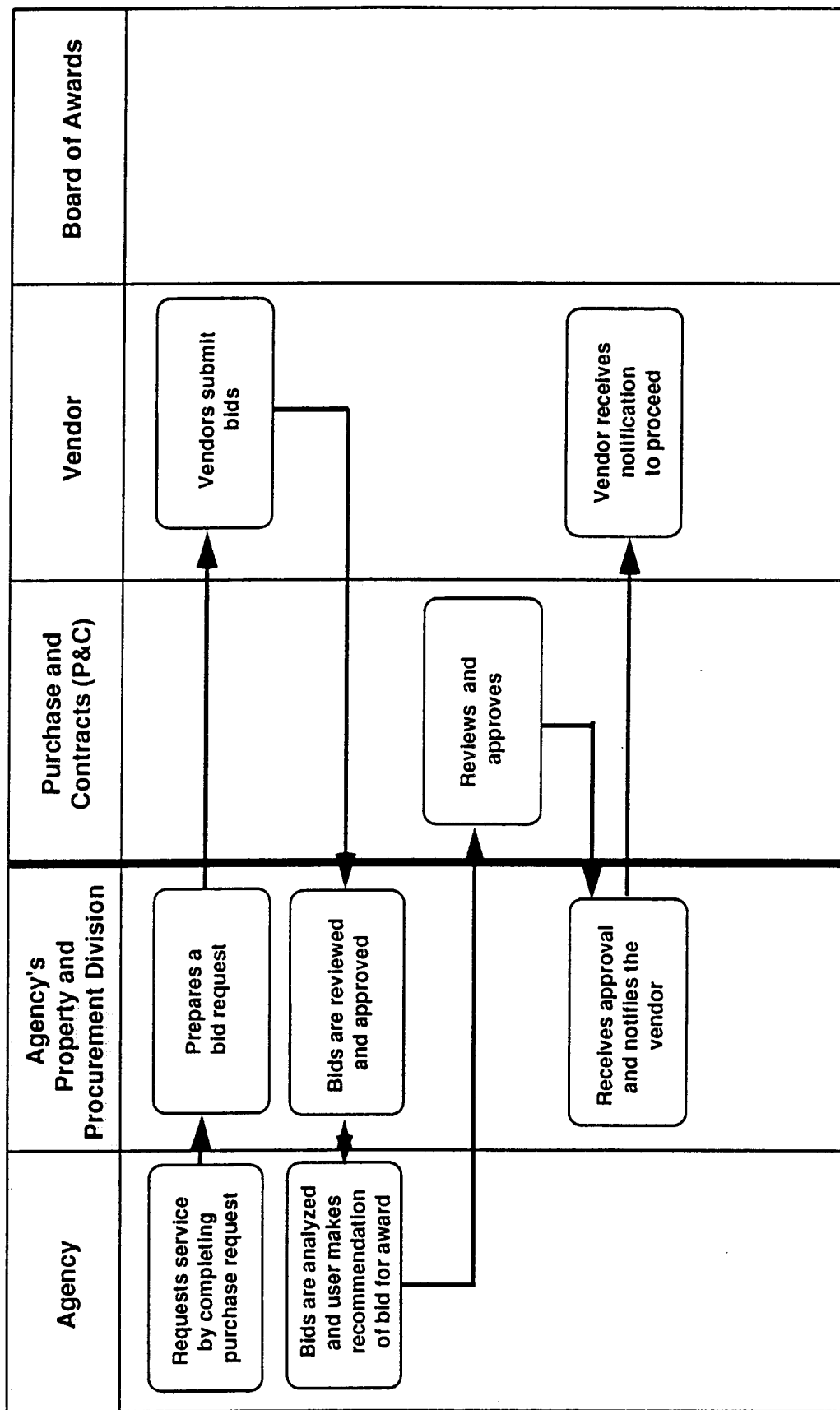
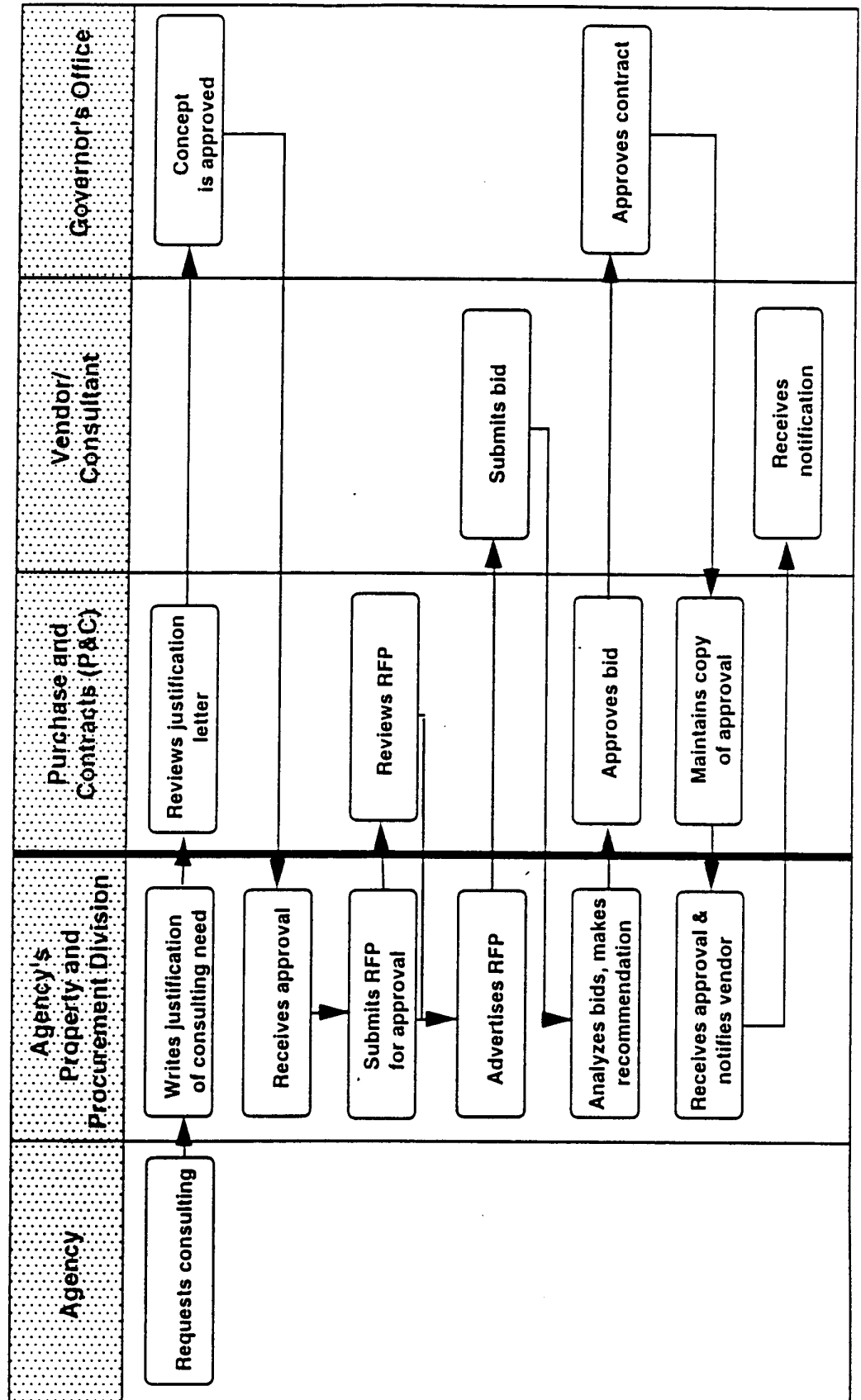


Exhibit 2-5 **North Carolina State Government** **Purchase and Contracts Work Flows** **Consulting Contracts**



Personal service contracts

Personal service contracts are used for procuring specialized services not available within the State government from an individual professional on a temporary or occasional basis. Examples of personal service contracts include services provided by a physician, dentist, attorney, architect, or professional engineer. A personal service contract is differentiated from a consulting contract in that a personal service contract delivers a service, whereas a consultant provides counsel, review, analysis, or advice in formulating or implementing improvements in programs or services.

Departments are delegated authority for soliciting personal service contracts, evaluating proposals received, and awarding these contracts. Exhibit 2-6 illustrates the personal service contract approval process.

Our audit disclosed that personal service contracts were very common at the department level. For example, the Department of Public Instruction awarded 1,200 personal service contracts for an amount of \$1.1 million in the 18-month period ending December 31, 1991. This compares with one consulting contract awarded in the same time period.

Term contracts

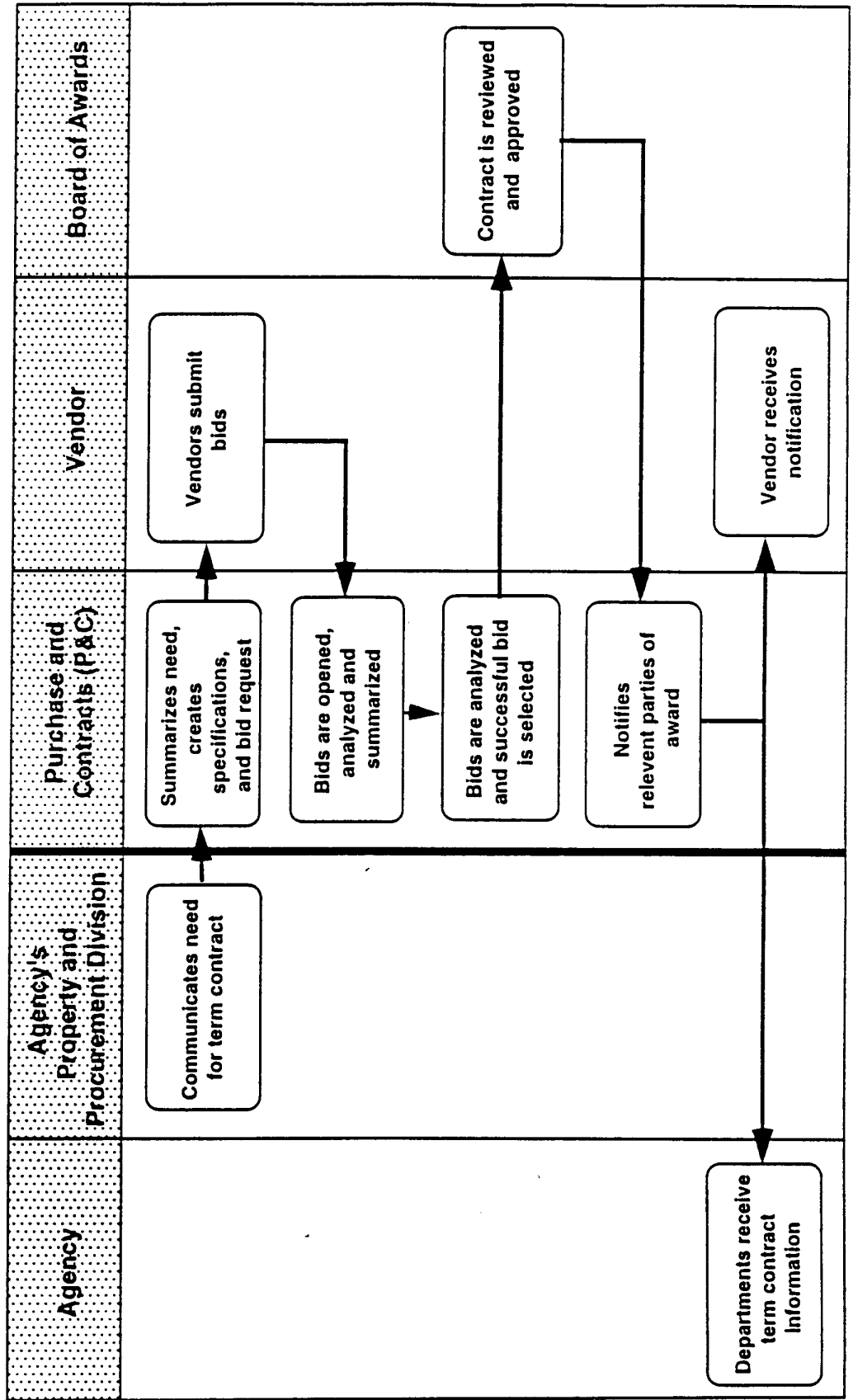
Term contracts are indefinite quantity contracts developed for the use of all agencies within the State government. Term contracts are executed by the Purchase and Contracts Division. The Purchase and Contracts Division gathers volume information for a type of commodity, develops an Invitation for Bid (IFB), and makes the contract award to a qualified vendor on the basis of the best offer of the bids received. Exhibit 2-7 illustrates the term contract bid and approval process.

Agencies within the State government are required to use term contracts to procure commodities available under them. Local governments and certain nonprofit agencies may opt to use the State term contracts (piggy-back) so that they can also make purchases at these negotiated rates. Some contracts specify a minimum or maximum dollar amount, under or over which the agencies are not required to use the contracts. Currently, the Purchase and Contracts Division has over 130 term contracts with an estimated total value of \$315 million.

The performance audit disclosed controversy concerning term contracts. In response to a questionnaire distributed to State employees, a significant number of employees contended that they could purchase items from local vendors for prices less than the term contract prices. The Purchase and Contracts Division contends that these claims are groundless and in each instance careful pricing analyses have been performed and the claims refuted. However, there is one notable exception in the case of the microcomputer term contract. Several departments complained about the microcomputer term contract and the inordinately high contract prices. The Purchase and Contracts Division reviewed the situation and

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Exhibit 2-7 **North Carolina State Government** **Purchase and Contracts Work Flows** **Term Contracts**



determined that market prices had dropped significantly since contract award. As a result, the microcomputer contract was canceled, effective April 1, 1992. Currently, there is no term contract for computer hardware and software.

Organization

The Purchase and Contracts Division comprises five sections:

- Purchasing
- Standards and Inspections
- Operations
- Auxiliary Services
- Printing

The Purchasing Section is responsible for processing agency requisitions for goods and services over the agency's delegated authority. The Purchasing Section is also responsible for assembling term contracts for use by agencies. The Purchasing Section consists of seven teams. Each team includes from three to six buyers, with one team leader. The responsibilities of each team are as follows:

- Team 1 - Agricultural equipment, fertilizer, aircraft, vehicles, and other related supplies
- Team 2 - Analytical equipment, audiometric rooms, research chemicals, drugs, and hospital supplies
- Team 3 - Bookbinding and bindery supplies, computer and snapout forms, copiers, duplicating supplies, and other printing equipment
- Team 4 - Arts and crafts, audiovisual equipment and supplies, chalkboards, educational training aids, musical equipment, library equipment and supplies, and all office equipment
- Team 5 - Animal equipment, athletic equipment, chemical supplies, clothing and textiles, disinfectants and cleaners, domestic appliances, food and food serving equipment, laundry chemicals and supplies, and paint
- Team 6 - Consulting contracts
- Team 7 - Computer equipment, electronic testing and analyzing equipment, cash registers, and voice data telecommunications

The Standards and Inspection Section, primarily made up of engineers, is responsible for developing specifications for commodities procured by the State and for maintaining the Qualified Products List, which contains 21 prequalified commodities. The Operations Section is responsible for maintaining information systems for the Division. The Auxiliary Services Section is responsible for minority purchasing programs. The Printing Section is in charge of coordinating printing services for the State.

Management information systems

The State of North Carolina uses a variety of manual and automated systems to conduct its procurement activities. The Purchase and Contracts Division uses the North Carolina Automated Purchasing System (NCAPS) to track term contract and open market purchases processed by the division and maintain historical purchasing information. The NCAPS system is complemented by a word processing system used to create invitations for bid, purchase orders, and contract forms. During the formal bid process, the NCAPS system is used in conjunction with a manual process for managing information.

Each department currently uses its own management information system to process purchase transactions. Periodically, departments download the purchase information to the Purchase and Contracts Division for reporting purposes. However, several departments are unable to download because purchasing information is maintained manually or on incompatible computer systems. The systems used at the department level are typically microcomputer-based software packages that run on a microcomputer network. Two examples of these packages include the system used by North Carolina State University and the system developed in-house by the Department of Environment, Health, and Natural Resources.

Currently, the State Controller's Office is attempting to implement, on a statewide basis, the Dun and Bradstreet purchasing system, which is a module of the Statewide Accounting System. Departments are planned to be incorporated into the Statewide Accounting System, including the Dun and Bradstreet purchasing system, but conversion has been slow to proceed.

Only limited information is available from the NCAPS system. For example, the Department of Public Instruction does not report purchases by local school districts to the Purchase and Contracts Division. Details concerning the types of purchases and the associated volume is unavailable. This limitation of the system hinders the ability of the Purchase and Contracts Division to track and access complete and accurate information on total procurement activities. This causes two primary problems:

- The Purchase and Contracts Division cannot properly monitor and oversee other departments' procurement activity.
- The management information system does not provide accurate information concerning purchasing volume for term contract vendors. As a result, the Purchase and Contracts

Division cannot ensure that the State receives the most competitive price from the vendor.

The Board of Award

The Board of Award is a 15-member body that meets weekly to review and approve the purchase of commodities and services by the Division of Purchase and Contracts, including term contracts and purchases that exceed the authority delegated to the departments and agencies. The Board of Award is composed of members of the North Carolina General Assembly and members of the business community.

Surplus operations

The State of North Carolina runs two property surplus operations:

- State Surplus Property Section
- Federal Surplus Property Section

The State Surplus Property Section disposed of approximately \$16 million worth of State surplus property in fiscal year 1991. State surplus may be sold to other state agencies, nonprofit organizations, local governments, or to private citizens. The Federal Surplus Property Section disposes of federal surplus goods that have not been provided to the State, local governments, and nonprofits. The Federal Surplus Property Section disposed of approximately \$8 million worth of property in fiscal year 1991.

Other general observations

The Purchase and Contracts Division maintains a qualified products list. This list contains 21 commodities that are prequalified based on review by the Standards and Inspection Section. This section also has developed specifications for approximately 135 commodities purchased by State agencies and departments.

As part of the study, we reviewed the State's program for purchasing from minority businesses. Under an executive order issued by the Governor, the State has a general goal of 4 percent procurement participation for minority-owned businesses. State statutes established a goal for the Department of Transportation of 15 percent for minority-owned businesses and a goal of 10 percent for women-owned businesses. The Office of State Construction has a goal established by State statutes of 10 percent for minority-owned businesses. Currently, according to State data, the State of North Carolina falls short of the Department of Transportation goal but exceeds the 10 percent goal for the Office of State Construction and the 4 percent statewide goal.

State survey of employees' views

In December 1991, the Government Performance Audit Committee distributed a questionnaire to all State employees soliciting their views on the effectiveness and efficiency of the State's operations and activities. The results of the employee survey disclosed numerous comments regarding employee dissatisfaction with the current purchasing process. Specific areas of concern pertained to:

- The length of time required to procure goods and services through the State purchasing system
- The mandated requirement to buy under State term contracts when the items could be purchased for less from local vendors

Vendor survey

As part of the performance audit, Peat Marwick surveyed vendors who were on the State bidders' list. The survey was sent to 78 vendors representing vendors who had:

- Been awarded open market contracts
- Unsuccessfully bid on open market contracts
- Been awarded term contracts
- Unsuccessfully bid on term contracts
- Not responded to invitations to bid requests

The objective of the survey was to solicit the views of vendors concerning the purchasing practices and procedures by the State of North Carolina.

The surveys assessed vendors' opinions concerning:

- Adequacy of the time allowed by the State to respond to a bid
- Extent that specifications issued by the State were perceived as being restrictive
- Accessibility to the Purchase and Contracts Division
- Familiarity with bid protest procedures
- Fairness of freight on board (FOB) destination requirements for shipping products to the State

The survey response rate was excellent--44 percent. A compilation of the results is provided as Exhibit 2-8. The majority of vendors responded that the Purchase and Contracts Division was helpful and the procurement process is managed efficiently. However, some concerns were expressed:

- No in-state preference is given to North Carolina businesses
- Product specifications are written to favor a particular vendor
- Bid protest procedures are not fully understood
- Information concerning past commodity purchases by the State is inadequate
- The Correction Enterprises products and services unfairly compete with private sector vendors

EXHIBIT 2-8**Summary of Vendor Survey Results**

	Question	Average Score*
1	When you receive notification of a request for bid by the State of North Carolina you are provided adequate time to respond.	3.44
2	The specifications describing the type of product/service requested by the State were adequate in explaining the requirement of the bid.	3.7
3	The specification describing the type of product/service requested did not provide an unfair advantage to a specific vendor or product.	3.41
4	If you requested assistance from the State concerning a request for bid, the Purchase and Contracts Division provided you with helpful assistance.	3.85
5	The request for bids adequately provided an emphasis on offers that contain prompt payment discounts as a factor in determining the lowest cost bidder.	3.29
6	The procedures to get your company/organization on the State's bidders' list are adequate.	3.82
7	The award of the contract after the bid opening was prompt.	3.47
8	The State Purchasing and Contracts Division has provided you with accurate and helpful information concerning the expected volume of purchases on term contracts.	3.35
9	You are familiar with the bid protest procedures.	2.64
10	A bid protest you have initiated has been handled fairly.	3.11
11	The State of North Carolina has made great strides to reach out to small and disadvantaged businesses.	3.76
12	You feel that the requirement of the vendor to bid FOB Destination with the vendor bearing the cost puts the vendor at a disadvantage when arriving at a competitive price.	2.97

* 1 = Total Disagreement and 5 = Total Agreement