

Memorandum



CITY OF DALLAS
(Report No. A14-008)

DATE: February 28, 2014

TO: Honorable Mayor and Members of the City Council

SUBJECT: Audit of Contract Compliance – Office Depot¹

Between January 2006 and August 2010, it appears the City of Dallas (City) incurred financial losses resulting from Office Depot's non-compliance with certain terms of Master Agreement Number 42595 (contract). Specifically:

- It appears Office Depot overcharged the City for office products purchased under the contract. The minimum amount of overcharges appears to be \$1.3 million based on a comparison of the prices paid by the City to the contracted prices. The

Background

In January 2006, the City joined a consortium agreement between United States Communities Government Purchasing Alliance (U.S. Communities), Los Angeles County, California, and Office Depot. The resulting contract allowed the City, along with numerous participating agencies nationwide, to receive discount pricing on office products.

The contract included a "Most Favored Public Entity" clause that required the vendor to extend lower pricing to the City if the same goods or services were provided under similar quantity and delivery conditions to the State of California or any county, municipality or district of the State at lower prices.

During the contract period (January 2006 – January 2011), the City paid Office Depot approximately \$10.1 million for the purchase of 279,410 line items, for an average annual expenditure of \$2.2 million.

Other participating agencies audited their contracts with Office Depot and reported overcharges and other instances of noncompliance.

Sources: Department of Communication and Information Services (CIS), Office Depot Usage Reports, and the contract

¹ We conducted an *Audit of Contract Compliance – Office Depot* under the authority of the City Charter, Chapter IX, Section 3. This audit was part of our Fiscal Year 2011 Audit Plan approved by the City Council. This performance audit was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. The audit objective was to verify Office Depot's compliance with contract pricing provisions. The scope of the audit included City billing records occurring between January 2006 and August 2010; however, certain other matters, procedures and transactions occurring outside that period may have been reviewed to understand and verify information related to the audit period. We interviewed Department of Business Development and Procurement Services and Office Depot personnel, reviewed the Office Depot contract with U.S. Communities, analyzed the City's billing data and Office Depot pricing data to determine if the City was charged in accordance with the contract, reviewed previously issued audit reports on Office Depot and verified mathematical accuracy. Additionally we reviewed applicable Council Resolutions, Administrative Directive 4-5, *Contracting Policy*, and the City Charter.

amount of overcharges could be \$3.6 million or higher based upon the “Most Favored Public Entity” clause in the contract (see text box on previous page). Office Depot disagreed with the conclusion that it appeared to overcharge the City of Dallas for office supplies. Office Depot cited multiple reasons for their disagreement.

- Office Depot owed, but did not pay the City, rebates totaling \$124,447 for purchases made between June 1, 2008 and December 31, 2010. (Note: The rebates were paid in August 2012 after being identified during this audit.)

Contract monitoring oversight and routine monitoring is much more challenging when the City participates in a consortium agreement. The Department of Business Development and Procurement Services (BDPS); however, did not have formal contract monitoring policies and procedures in place to guide BDPS personnel in establishing monitoring oversight responsibilities and conducting routine monitoring activities to verify that Office Depot and City departments complied with the contract. Specifically:

- A signed copy of the original master agreement was not retained to identify key contract provisions related to Office Depot
- Copies of approved Office Depot price lists and formal approval letters from Los Angeles County, California (Los Angeles County), as well as all signed contract amendments, were not available and used to ensure Office Depot charged the City appropriately
- City departments purchased office products that did not comply with the contract as follows:
 - \$2,550,359 for 32,016 office products that were not included in the Office Depot price lists approved by Los Angeles County
 - \$225,355 for 2,471 office products at the universal (market) price which was not a contractually agreed upon pricing method

Additionally, between June 2009 and August 2010, BDPS increased the Office Depot contract by approximately \$900,000 (14 percent of the original \$6.5 million contract) by processing 35 individual change orders. Change order number seven contained a \$100,000 mathematical error in the calculation of the “previous increases by change orders”. This mathematical error was carried through to the remaining change orders, effectively increasing the contract by \$100,000 instead of the \$25,000 limit per change order delegated by the City Manager.

The amount of each of the change orders and the cumulative total percentage of 14 percent as compared to the original contract was allowable under Administrative Directive 4-5, *Contracting Policy* (AD 4-5) (see textbox on this page); however, the total result was a significant increase in purchasing authority under the contract without additional oversight and approval by the City Council.

Although the change orders discussed above were allowable, they were not processed in accordance with AD 4-5. The BDPS did not appropriately route the change orders to the City Attorney's Office for review and approval as to form and to the City Secretary's Office for validation of all required review and approval signatures.

Change Orders and Consultant Contract Amendments

If it becomes necessary to make a change order to a contract...the City Manager or his designee may approve these changes by Administrative Actions if the change order involves a decrease or increase in cost of \$25,000 or less. The cumulative change orders may not increase the original contract by more than 25 percent.

Additionally, Chapter XXII, Section 6 of the City Charter and Section 230(f) of the City Code authorizes the City Manager to delegate change order approval authority (when authorized by State law) to the Department Directors for additive or deductive change orders for \$25,000 or less on contracts for which the delegated department directors have responsibility for administration.

Source: AD 4-5, effective January 6, 2006, and the City Charter

The City also paid \$276,373 for 941 office products which each exceeded the authorized limit of \$150 per Council Resolutions (CRs). According to the CRs, City departments were prohibited from purchasing unallowable items, each exceeding \$150, such as toner cartridges for LaserJet printers, digital cameras, fax machines, and microwaves.

The Committee of Sponsoring Organizations (COSO) Internal Control Integrated Framework, which is recognized as a leading framework for designing, implementing, and conducting internal control and assessing the effectiveness of internal control, identified:

- Monitoring as a key input into the organization's assessment of the effectiveness of internal controls
- Established policies and procedures as a control activity needed to manage risk
- Transaction controls as control activities that directly support the actions to mitigate transaction processing risks in an entity's business processes

The AD 4-5 governs the contracting process and specifies the following:

- All change orders shall be routed to the City Attorney's Office for review and approval as to form
- The change order is approved by the initiating department director and routed intact, with supporting data attached, to the City Secretary's Office. The initiating department shall submit the change order to the City Secretary for validation only upon securing all necessary review and approval signatures.

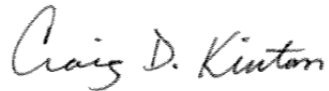
We recommend the:

- I. City Manager, with the assistance of the City Attorney's Office, initiate actions to collect the overcharges from Office Depot
- II. Director of BDPS improve contract monitoring by developing formal policies and procedures that ensure BDPS personnel identify:
 - Key contract provisions
 - Monitoring oversight responsibilities
 - Monitoring activities, including the documentation necessary to demonstrate that appropriate monitoring occurred
- III. City Manager consider amending AD 4-5 to add limits on the number and/or amount of change orders authorized to department directors through the City Manager's delegation
- IV. Director of BDPS amend AD 4-5 to include appropriate processing controls for change orders

Please see Attachment I for Background and Attachment II for Management's Response to the report recommendations.

We would like to acknowledge City management's and Office Depot's cooperation in providing the information needed to complete this audit. If you have any questions or need additional information, please contact me at 214-670-3222 or Carol Smith, First Assistant City Auditor, at 214-670-4517.

Sincerely,

A handwritten signature in black ink that reads "Craig D. Kinton". The signature is written in a cursive, flowing style.

Craig D. Kinton
City Auditor

Attachments

C: A.C. Gonzalez, City Manager
Jeanne Chipperfield, Chief Financial Officer
Michael Frosch, Director – Department of Business Development and Procurement Services
Warren M.S. Ernst, City Attorney
David Trudnowski, Vice President, Public Sector – Office Depot
Mark Matranga, National Program Manager, Public Sector, Central Region – Office Depot

Background

The Department of Business Development and Procurement Services (BDPS) administers the City of Dallas' (City) centralized purchasing system. The BDPS is responsible for developing bid specifications jointly with City departments, obtaining bids through advertising and direct solicitation, establishing and monitoring master agreement contracts, such as the Office Depot contract, and issuing purchase orders.

Office Depot Contract

April 9, 2003 – The City Council authorized the City to participate in the United States Communities Government Purchasing Alliance (U.S. Communities) Administrative Agreement for 24 months for the purchase of office supplies through Office Depot, Business Services Division in an amount not to exceed \$4.5 million. The agreement allowed the City to receive discount pricing on office products.

January 2006 – The City joined a consortium agreement between United States Communities Government Purchasing Alliance (U.S. Communities), Los Angeles County, California, and Office Depot. The resulting contract allowed the City to continue receiving discount pricing on office products. This agreement was administered utilizing a web based system with secure log-in and passwords for users to access contracted items; however, other purchase methods such as phone, fax, mail order and walk-in were also processed under the agreement.

United States Communities Government Purchasing Alliance

United States Communities Government Purchasing Alliance (U.S. Communities) is a non-profit government purchasing cooperative that reduces the cost of goods and services for participating agencies by aggregating their purchasing power nationwide. Generally, the following agencies are eligible to use the U.S. Communities Program:

- Counties, Cities, Towns and Villages
- Special Districts (e.g., Fire, Sewer, Water, etc.)
- Public Schools, including: K-12, Community Colleges, Universities, Technical, and Vocational
- State Agencies
- Other Local Governments
- Nonprofit Corporations (including Private K-12, Private Colleges, and Universities)

Source: U.S. Communities

The Dallas City Council authorized the following to continue the City's participation with U.S. Communities.

- August 21, 2006 – A \$6.5 million 36-month master agreement (contract) with a 12-month extension option
- January 28, 2009 – A \$1.625 million master agreement increase

In addition, between June 2009 and August 2010, BDPS independently processed 35 change orders totaling approximately \$900,000.

Between January 2, 2006 and August 31, 2010, the City paid Office Depot approximately \$10.1 million for the purchase of 279,410 line items for an average annual expenditure of \$2.2 million. According to the contract, the City was entitled to a: (1) two percent volume rebate for spending between \$1 million and \$3.5 million annually; and, (2) one percent e-commerce rebate annually if 80 percent of the eligible purchases are ordered via e-commerce.

Table I below shows the total number of line items purchased and the payment amount by calendar year. (Note: Office Depot payments may cover multiple line items on multiple invoices; as a result, the total number of line items was used for this analysis.)

Table I

**City Payments to Office Depot
by Calendar Year**

| Year | Amount | Line Items** |
|--------------|----------------------|---------------------|
| 2006 | \$ 2,271,398 | 64,060 |
| 2007 | 2,663,042 | 70,298 |
| 2008 | 2,352,385 | 62,360 |
| 2009 | 1,945,370 | 47,470 |
| 2010* | 821,074 | 19,685 |
| Total | \$ 10,053,269 | 263,873 |

Notes:

* The amount shown in Table I above for the calendar year 2010 is not a complete year because the City stopped ordering office supplies from Office Depot after July 2010.

** Of the 279,410 line items processed, 15,537 line items totaling \$16,686 were excluded, resulting in 263,873 line items for office supplies. The excluded line items include delivery charges, cancelled orders, and setup fees.

Source: Department of Communication and Information Services (CIS) Office Depot Billing Records between January 2006 and August 2010

The Office Depot price lists contained Core and Non-Core items. The Core items had fixed prices and reflected the products the City purchased most frequently. The Non-Core item prices were based on various discount structures. In the price lists for the 2006-2009 calendar years, the main Core items were pens, printer cartridges, toner, folders, binders, notepads, envelopes, and paper clips. In the price lists for the 2009-2010 calendar years, additional items, such as paper products, markers, washable paint and paint-related products, were added to the Core item list.

Table II below shows the City's payments to Office Depot by calendar year for Core and Non-Core items.

Table II

**City Payments for Core and Non-Core items
By Calendar Year**

| Year | Core | Non-Core | Total Core/ Non-Core |
|--------------|---------------------|---------------------|---------------------------------|
| 2006 | \$ 418,419 | \$ 1,852,979 | \$ 2,271,398 |
| 2007 | 355,955 | 2,307,087 | 2,663,042 |
| 2008 | 305,333 | 2,047,052 | 2,352,385 |
| 2009 | 631,930 | 1,313,440 | 1,945,370 |
| 2010 | 111,499* | 709,575 | 821,074 |
| Total | \$ 1,823,136 | \$ 8,230,133 | \$ 10,053,269 |

Note: * The amount shown in Table II above for the calendar year 2010 is not a complete year because the City stopped ordering office supplies from Office Depot after July 2010.

Source: CIS Office Depot Billing Records between January 2006 and August 2010

Methodology

- Reviewed the Office Depot contract and nine amendments
- Communicated with the Office Depot audit liaison in person, by e-mail, and by telephone to obtain an understanding of the Office Depot contract provisions, including any amendments, applicable price lists, and usage reports
- Used Audit Command Language (ACL) audit software to compare the prices paid by the City for 100 percent of the Office Depot transactions to the 13 different Office Depot price lists released during the contract period. Specifically, the auditor:
 - Obtained the 13 historical price lists from Office Depot and validated the accuracy of the contract price based upon the formula of list price, discount rate, and minimum gross profit margin
 - Obtained the usage reports from Office Depot and compared them to the City's billing records to assess the reliability of the usage reports. (Note: The usage reports include information such as the items purchased, contracted prices, and paid prices.)
 - Analyzed the usage reports by comparing the contracted prices to the

prices paid by the City for each transaction

- Performed a reasonableness test for the 2006-2010 calendar year rebates by comparing the total amount spent from the City's billing records to the Office Depot usage reports
- Used ACL audit software to compare the prices paid by the City to the price lists obtained from the City of Houston, Texas; Dallas County, Texas; and, City and County of San Francisco, California
- Reviewed audit reports on Office Depot issued by other cities and counties

Management's Response

Memorandum

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FEB 21 2014

City Auditor's Office



DATE: February 21 , 2014
TO: Craig D. Kinton, City Auditor
SUBJECT: Response to Audit Report: Audit of Contract Compliance – Office Depot

Business Development and Procurement Services (BDPS) examined your office's findings and recommendation and prepared the attached response addressing your office's concerns and support your recommendations. BDPS remains committed to the effective and efficient management of all contracts administered by the department. BDPS supports the Auditor's recommendations for continuing improvements and will take the necessary steps for implementation.

Our responses to the audit report recommendations are as follows:

Recommendation I

We recommend the City Manager, with the assistance of the City Attorney's Office, initiate actions to collect the overcharges from Office Depot.

Management Response / Corrective Action Plan

Agree Disagree

The City Manager's Office will consult with the City Attorney's Office regarding the City's rights and options to pursue reimbursement of improper charges.

Implementation Date

TBD

Responsible Manager

Chief Financial Officer

Recommendation II

We recommend the Director of Business Development and Procurement Services (BDPS) improve contract monitoring by developing formal policies and procedures that ensure BDPS personnel identify:

- Key contract provisions
- Monitoring oversight responsibilities
- Monitoring activities, including the documentation necessary to demonstrate that appropriate monitoring occurred

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Management Response / Corrective Action Plan

Agree Disagree

BDPS agrees to develop formal policies and procedures that ensure BDPS personnel identify:

- Key contract provisions
- Monitoring oversight responsibilities
- Monitoring activities, including the documentation necessary to demonstrate that appropriate monitoring occurred

Implementation Date

May 2014

Responsible Manager

Express Business Center Manager

Recommendation III

We recommend the City Manager consider amending AD 4-5 to add limits on the number and/or amount of change orders authorized to department directors through the City Manager's delegation.

Management Response / Corrective Action Plan

Agree Disagree

The procurement process will be reviewed this fiscal year and all current practices will be reviewed to see if they meet the changing needs of the City.

Implementation Date

September 2014.

Responsible Manager

BDPS Director

Recommendation IV

We recommend the Director of BDPS amend AD 4-5 to include appropriate processing controls for change orders.

Management Response / Corrective Action Plan

Agree Disagree

The procurement process will be reviewed this fiscal year and all current practices will be reviewed to see if they meet the changing needs of the City.

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Audit of Contract Compliance – Office Depot

Implementation Date

September 2014

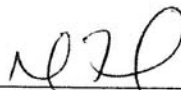
Responsible Manager

BDPS Director

Sincerely,



Jeanne Chipperfield,
Chief Financial Officer



Michael Frosch
Department of Business Development
and Procurement Services

C: A.C. Gonzalez, City Manager
Warren M.S. Ernst, City Attorney

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