# SPEND ANALYSIS AND PROCUREMENT CONSULTING SERVICES

## SPECIAL REPORT

## JANUARY 2004

Auditor of Public Accounts
COMMONWEALTH OF VIRGINIA

# EXECUTIVE SUMMARY

We reviewed the financing plan for spend analysis and procurement consulting services. We have concerns about the initial method of funding for this project.

### *FUNDING PURPOSE*

The Secretaries of Administration and Finance authorized General Services to borrow and use eVA funding to pay the contract with Silver Oak. Subsequently, General Services obligated the Commonwealth for almost $5 million without first obtaining additional appropriations for the spend analysis and procurement consulting services. As a result of this issue, we have made the following recommendations.

- The General Assembly may wish to examine the authority of agencies and institutions to implement programs or initiatives for which there has not been a specific appropriation or authority to borrow funding from the State Treasury. The General Assembly may need to consider whether there is a need to change the Appropriations Act to clarify the circumstances under which such actions can occur.

House Bill 29 proposes amendments to the fiscal year 2004 budget, including language for a $5 million treasury loan to support Virginia Partners in Procurement spend management effort.

- If the Governor and General Assembly wish to continue the term of the proposed loan beyond the current fiscal year to support the Virginia Partners in Procurement spend management effort, the proposed amendments to the Budget Bill contained in House Bill 29, as introduced, should be repeated in House Bill 30, which is the 2004-2006 Biennium Budget Bill.

### *OTHER ISSUES*

- The Procurement Appeals Board found flaws in both the scoring methodology and negotiations process for the office supplies procurement, which may affect the financing plan and cost reduction calculations.

- General Services and Virginia Partners in Procurement are each using different scenarios to project future activity of the spend management effort. General Services is using a more conservative scenario in developing the financing plan, while Virginia Partners in Procurement is using an almost total compliance scenario to calculate cost reductions. Based on the total compliance scenario, Virginia Partners in Procurement is communicating that the spend analysis project will result in $25 million in cost reductions. However, based on the same methodology used to compile the financing plan, total cost reduction may only amount to $16 million. Further, of the $16 million only $7.6 million and $4.8 million will be directly available to agencies and institutions.

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# Commonwealth of Virginia

**Walter J. Kucharski, Auditor**

**Auditor of Public Accounts**
**P.O. Box 1295**
**Richmond, Virginia 23218**

January 12, 2004

The Honorable Mark R. Warner
Governor of Virginia
State Capital
Richmond, Virginia

The Honorable Kevin G. Miller
Chairman, Joint Legislative Audit
and Review Commission
General Assembly Building
Richmond, Virginia

We have completed a follow-up review of the spend analysis and procurement consulting services obtained through a contract between the Department of General Services (General Services) and Silver Oak Solutions (Silver Oak).

*Objectives*

We had two objectives for our review. These objectives were to:

1. review the financing plan for the Silver Oak contract to determine its reasonableness and its effect on agencies and higher education institutions;

2. review the status of Silver Oak's cost reduction calculations to determine their reasonableness.

*Scope*

In performing our work, we reviewed the financing plan and supporting documentation, and analyzed the procurement and payment activity. We also interviewed General Services' staff on the procurement and contracts for Phase 2.

We discussed this report with General Services' management on January 12, 2004.

AUDITOR OF PUBLIC ACCOUNTS

## Introduction

The Department of General Services (General Services) contracted with Silver Oak Solutions, Inc. (Silver Oak), for spend analysis and procurement consulting services. Our office completed a report titled, "Spend Analysis and Procurement Consulting Services" dated November 25, 2003 that addressed the lack of financing arrangements and other issues General Services and others will need to monitor.

We have completed a follow-up review, which includes an examination of the financing plan to determine the reasonableness of any cost recovery of the cost of Silver Oak contract, collection of rebate, incentive and surcharge payments, and the impact that the plan and collection of any fees will have on agencies and institutions.

## Financing Plan

In October 2002, the Secretary of Administration directed General Services to issue a competitive request for proposal for consulting services to provide spend analysis services. The contract for spend analysis services includes analyzing the Commonwealth's purchasing data, developing an alternative procurement strategy to obtain better pricing, and training contracting officers on the process. General Services awarded a contract to Silver Oak Solutions, Inc. (Silver Oak) on December 20, 2002. Silver Oak is a national firm that analyzes spend data and uses various procurement strategies to obtain better prices. The contract period of performance is from December 20, 2002 through June 30, 2003 with General Services exercising an option to extend through February 10, 2004. The contract value including the three subsequent amendments is a not-to-exceed price of $4,746,993 which includes service fees and travel expenses. For Phase 1, Silver Oak provided estimated savings calculations, which General Services agreed has met the estimated contractual savings guarantee, therefore, General Services must pay Silver Oak for related service fees and travel expenses.

For the initial phase of the Silver Oak project, Secretaries of Administration and Finance (Secretaries) approved a decision brief that authorized General Services to pay for the cost of consultant services using the treasury loan available for eVA implementation and repay the loan through surcharges and rebates received from vendors. The decision brief justified the use of these funds for the spend analysis effort as reasonable towards the development and implementation of eVA. Because funds were available, General Services paid Silver Oak using the funds collected from agencies and institutions and earmarked for the development and implementation of eVA. General Services has paid Silver Oak a total of $3,558,667 using $1,440,591 in general funds and $2,118,076 in nongeneral funds earmarked for the development and implementation of eVA. With expenses related to both eVA and the spend analysis project exceeding available funding, as of November 30, 2003, General Services has obtained $3.3 million in treasury loans.

During the eleventh month of the project at the exit conference for our first report, General Services provided a financing plan. We reviewed the financing plan, and while we have some reservations, it appears to be reasonable. We discuss the methodology and our reservations later in this report. We do have a primary concern with the procurement of the Spend Analysis Consulting Services, which we will discuss in the following section.

Funding Purpose

Our primary concern is that the Secretaries authorized General Services to borrow and use eVA funding to pay the contract with Silver Oak. General Services obligated the Commonwealth for almost $5 million without first obtaining additional appropriations for the spend analysis and procurement consulting services. The original intent of the eVA funds was for the development and implementation of eVA.

The objectives for the spend analysis effort are more in line with General Services' standard duties, which include establishing statewide contracts to assist agencies with the purchases of goods and non-professional services. Had General Services either received additional funding through transfers from a central account or used general fund sources other than the eVA enterprise fund, we would not have the above concern.

Silver Oak has nearly received full payment for its services, however, General Services has used funding for another purpose to pay for these services. Additionally, even if the savings projected for this contract do occur, it will take the Commonwealth at least until 2007 to recover and pay off the Treasury loan and reinstate the cash taken from eVA.

The appropriations process is a major control mechanism used by the Commonwealth. Appropriations provide both the authorization to expend, and the limitation of expenditures. This mechanism ensures that agencies spend funds as intended. By using eVA funding to pay the contract with Silver Oak, General Services may have bypassed this critical control process.

***Recommendation:*** The General Assembly may wish to examine the authority of agencies and institutions to implement programs or initiatives for which there has not been a specific appropriation or authority to borrow funding from the State Treasury. The General Assembly may need to consider whether there is a need to change the Appropriations Act to clarify the circumstances under which such actions can occur.

House Bill 29 proposes amendments to the fiscal year 2004 budget, including language for a $5 million treasury loan to support Virginia Partners in Procurement spend management effort. This amendment will allow the use of the Treasury loan in lieu of the funding borrowed from the eVA fund. However, House Bill 30, which is the 2004-2006 Biennium Budget Bill does not include language specific to Virginia Partners in Procurement spend management effort or eVA.

***Recommendation:*** If the Governor and General Assembly wish to continue the term of the proposed loan beyond the current fiscal year to support the Virginia Partners in Procurement spend management effort, the proposed amendments to the Budget Bill contained in House Bill 29, as introduced, should be repeated in House Bill 30, which is the 2004-2006 Biennium Budget Bill.

Financing Plan Methodology

In order to develop a financing plan, General Services forecasted revenue collections using projected rebates, surcharges, and price reduction amounts provided by Silver Oak. Silver Oak used two scenarios when calculating their projections. The first scenario assumes that agencies, institutions, and municipalities will purchase 100 percent of all Phase 1 commodities, except for office supplies, using the contracts procured through Silver Oak. The second scenario is a more conservative estimate, and assumes that agencies, institutions, and municipalities will purchase 40 to 75 percent of all Phase 1 commodities using the contracts procured through Silver Oak.

General Services used the more conservative scenario to compile the financing plan. Anticipated revenues for the financing plan include surcharges and rebates of $1.7 million for fiscal year 2004, and $3.2 million for fiscal years 2005 through 2008. While to date, General Services has collected no surcharges, rebates or incentives; it expects to collect rebates annually and surcharges quarterly. Anticipated costs include transfers to the Virginia Information Technology Agency (VITA) for the information technology software and hardware contracts they administer, and a new staff unit to perform analysis currently performed by Silver Oak. General Services expects total operating costs and transfers of $1.0 million for fiscal year 2004, $1.3 million for fiscal years 2005 and 2006, and $1.7 million for fiscal years 2007 and 2008. In addition, General Services plans to obtain a treasury loan of $4,746,994 and make full repayment by fiscal year 2007. Appendix A provides more detailed information on the financing plan.

In addition, we noted an issue during our review, which may affect the financing plan as well as cost reduction calculation projections. The former office supply vendor protested the award for the new contract procured through Silver Oak. The Procurement Appeals Board found flaws in both the scoring methodology and negotiations process for the office supplies procurement. As a result, General Services has chosen to recompete this procurement.. To account for this issue, General Services has adjusted revenue in the financing plan by implementing a six-month delay in collection of related rebates and surcharges. However, the financing plan assumes that the new office supplies contract will contain the same pricing and cost reduction potential, which the Commonwealth may not realize. In addition, the plan does not consider the additional resources expended by General Services as part of the costs of the spend management effort.

## Cost Reduction Calculations

As mentioned in the previous section, Silver Oak provided rebate and cost reduction projections using two scenarios. While General Services is using the more conservative scenario to compile the financing plan, the Virginia Partners in Procurement is using the total compliance scenario in public announcements.

For example, Virginia Partners in Procurement communicate that statewide contracts procured through the spend analysis project will result in $25 million in cost reductions. This estimate assumes that agencies, institutions, and municipalities will use these contracts for 100 percent all Phase 1 commodities, except for office supplies, which has estimated usage at 75 percent. Consequently, realized annual cost reduction may be much less than the Commonwealth's estimated annual cost reduction of $25 million. While the estimated cost reduction calculation satisfies the guarantee set forth in the contract, the bigger issue is what the Commonwealth plans to do with this information. The possibility exists that the Department of Planning and Budget, the Governor, or the General Assembly, may reduce agency budgets based on the estimated cost reduction calculation

Virginia Partners in Procurement should use the more conservative scenario to determine the cost reduction amounts used in public announcements. While the conservative scenario results in a total cost reduction amount of $16 million, this figure includes municipalities as well as state entities. In addition, since General Services will receive the rebates, the only cost reductions directly available to agencies and institutions are $7.6 million and $4.8 million, respectively.

| | Total Compliance Scenario | Conservative Scenario |
|---|---|---|
| Cost Reductions: | | |
| Agencies | $ 10,871,257 | $ 7,554,708 |
| Higher Education Institutions | 8,114,288 | 4,753,892 |
| Municipalities | 4,813,854 | 2,891,968 |
| Total | 23,799,399 | 15,200,568 |
| Rebate & Incentives | 1,576,576 | 1,170,552 |
| Total Cost Reduction | $ 25,375,975 | $ 16,371,120 |

Future Issues Requiring Resolution

As we stated in our last report, General Services should continue their efforts to increase participation of agencies and institutions including involving major university participation such as in user groups General Services has received no rebates or incentive payments.  A system that generates a substantial portion of the saving from rebates and incentive payments is highly dependent on a system that can monitor spending activity.  If General Services cannot capture information to determine that the Commonwealth has earned a rebate or incentive payment and received the money, then the Commonwealth has not benefited from this process.

APPENDIX A
Silver Oak Financing Plan

| | FY04 | FY05 | FY06 | FY07 | FY08 | FY09 |
|---|---|---|---|---|---|---|
| Surcharges | $1,255,289 | $2,009,639 | $ 2,009,639 | $2,009,639 | $ 2,009,639 | $ 763,224 |
| Rebates & Incentives | 430,173 | 1,170,552 | 1,170,552 | 1,170,552 | 1,170,552 | 803,741 |
| Total Projected Revenue | 1,685,462 | 3,180,191 | 3,180,191 | 3,180,191 | 3,180,191 | 1,566,965 |
| Transfers to VITA | 666,627 | 911,579 | 911,579 | 1,360,566 | 1,360,566 | 340,141 |
| Operating costs of new staff unit | 327,000 | 349,557 | 349,557 | 349,557 | 349,557 | 349,557 |
| Total Operating Costs and Transfers | 993,627 | 1,261,136 | 1,261,136 | 1,710,123 | 1,710,123 | 689,698 |
| Available for loan payment | 691,835 | 1,919,055 | 1,919,055 | 1,470,068 | 1,470,068 | 877,267 |
| Estimated loan repayment | 691,835 | 1,919,055 | 1,919,055 | 217,049 | - | - |
| Estimated Cash Balance at FYE | $ - | $ - | $ - | $1,253,019 | $ 2,723,087 | $3,600,354 |

# COMMONWEALTH *of* VIRGINIA

*Department of General Services*

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Director

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January 12, 2004

Mr. Walter J. Kucharski
Auditor of Public Accounts
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Dear Walt:

Thank you for the opportunity to review your report, Spend Analysis and Procurement Consulting Services, and for considering our comments on the earlier drafts. We are very pleased to see you continue to view the Virginia Partners in Procurement (VaPP) as a successful initiative.

We believe the information set forth in the report is substantially accurate, and have no additional comments to make at this time. We look forward to working with you on this, and other matters of mutual interest.

Sincerely,

James T. Roberts
Director



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