

Evaluation of State Purchasing

Program Evaluation Division
Office of the Legislative Auditor
State of Minnesota

Program Evaluation Division

The Minnesota Legislature established the Program Evaluation Division within the Office of the Legislative Auditor in 1975. The division's mission, as set forth in statute, is to determine the degree to which activities and programs entered into or funded by the state are accomplishing their goals and objectives and utilizing resources efficiently.

The division conducts six to eight major evaluations each year. Each evaluation includes a *program review*, which describes program activities. In addition, most evaluations address: 1) *compliance issues*, which examine whether the program is implemented consistent with law and legislative intent, 2) *economy and efficiency issues*, which assess whether the program is managed efficiently and cost effectively, 3) *program effectiveness issues*, which determine whether the program is achieving its objectives, and/or 4) *policy issues*, which concern the impact of current state policy and the costs and benefits of policy alternatives.

The division also conducts follow-up studies, updates previous research findings, and evaluates annual performance reports prepared by state agencies.

Topics for study are approved by the Legislative Audit Commission (LAC), a 16-member bipartisan oversight committee. The division's reports, however, are solely the responsibility of the Office of the Legislative Auditor. Findings, conclusions, and recommendations do not necessarily reflect the views of the LAC or any of its members.

The Office of the Legislative Auditor also includes a Financial Audit Division, which annually conducts a statewide audit of the 25 largest agencies, the federal single audit, and approximately 40 financial and compliance audits of individual state agencies.

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PREFACE

In June 1981, the Legislative Audit Commission directed the Program Evaluation Division to conduct an independent evaluation of state purchasing. This report presents the results of our evaluation.


We find that a number of improvements in state purchasing are needed. In particular, we recommend an increase in local purchasing authority that could save the state up to \$400,000 each biennium. We also recommend that the standards and value engineering activity be reestablished within the Procurement Division of the Department of Administration. This activity can be funded for a fraction of the above savings and has excellent potential for saving the state much money in the long run.

Our study has benefited from the full cooperation of the Procurement Division's management and staff. We hope this report will help the division and other state agencies by improving state purchasing operations.

This study was directed by John Yunker of the Program Evaluation Division staff. Kathryn Buxton conducted the research for the study.



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PROGRAM EVALUATION DIVISION

The Program Evaluation Division has been established to conduct studies at the direction of the Legislative Audit Commission (LAC). The division's general responsibility, as set forth in statute, is to determine the degree to which activities and programs entered into or funded by the state are accomplishing their goals and objectives and utilizing resources efficiently. A list of the division's studies appears at the end of this report.

The findings, conclusions, and recommendations in Program Evaluation Division reports are solely the product of the division's staff and not necessarily the position of the LAC. Upon completion, reports are sent to the LAC for review and are distributed to other interested legislators and legislative staff.

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EXECUTIVE SUMMARY

Purchases of supplies, equipment, materials, and services are a substantial factor in the cost of operating state government. During the 1979-81 biennium, state agencies made \$180 million worth of purchases through the Procurement Division of the Department of Administration and an additional \$50 to \$60 million of purchases directly.

As a result, state purchasing has been a continuing concern to agency officials, governors, and legislators. In the last ten years, the subject has been studied by a number of groups, including the Loaned Executives Action Program (1972), the Governor's Special Task Force on Procurement and Materials Management (1978), and the Procurement Advisory Committee (1979). Some of the changes recommended by these groups have been implemented and have improved state purchasing operations.

Significant changes in two key areas of purchasing are still needed however. These are the areas of: (1) delegated or local purchasing authority for state agencies and (2) value analysis or life cycle costing.

A. LOCAL PURCHASING AUTHORITY

Currently, state agencies cannot directly purchase most items costing more than \$50. As a result, a large percentage of the Procurement Division's workload continues to include small purchase orders. We estimate that 61 percent of the purchase orders in fiscal year 1980 were for less than \$500. These small transactions account for less than five percent of the total dollar volume of purchase orders processed by the division.

This situation remains basically unchanged from the one that led the Governor's Special Task Force to recommend in 1978 that agencies be permitted to purchase items up to \$300 when there is an immediate need. That change has not, however, had the desired effect of reducing the share of Procurement's workload that consists of small purchase orders.

Our detailed analysis of purchase orders also substantiates the task force's finding that the cost of processing small purchase orders exceeds any possible savings. Based on a random sample of 300 purchase orders of \$500 or less, we found that:

- Agencies recommended vendors to the Procurement Division on 96 percent of the requisitions and the division awarded the purchase to the agency recommended vendor in 75 percent of these cases.

- The specifications prepared by the agency were modified by the Procurement Division in only six percent of the cases.
- In at least 24 percent of the cases, the items purchased were proprietary and the division contacted only one vendor anyway.

We conclude that processing purchase orders of \$500 or less through the Procurement Division has little impact on purchasing decisions.

Furthermore, we find that this view is shared by most other states, even those that have computerized their central purchasing operations. According to a 1979 study by the Council of State Governments, 45 other states permit state agencies to purchase items costing more than \$50. A majority of the states permit local purchases up to at least \$500.

As a result, we recommend that local purchasing authority be increased to \$500 with three informal bids required. Implementation of the recommendation could save the state up to \$400,000 each biennium depending on how many agencies use their increased authority.

B. STANDARDS AND ENGINEERING SECTION

All three previous studies of state purchasing were concerned with the lack of emphasis on product quality. It was believed that the Procurement Division placed too much emphasis on buying items with the lowest initial cost and not enough emphasis on the product's value over its lifetime.

As a result of the 1972 LEAP report, a Standards and Engineering Section was created within the Procurement Division. The 1978 task force report recommended an upgrading of the section to enable it to do value analysis or life cycle costing. Instead, the section was abolished in 1981 as part of the reduction in the state's labor force.

There are a number of reasons for the section's failure to accomplish the goals set in previous studies. Foremost among the reasons are: (1) the section lacked the support of past division management, and (2) the section lacked certain technical engineering expertise. Although the division has assigned the section's responsibilities to the division's buyers, this is unlikely to be successful since the buyers also generally lack the needed expertise.

The loss of the Standards and Engineering Section has also eliminated funds for product testing. As a result, the state is no longer able to perform laboratory tests to determine if products delivered to the state meet contract specifications. In the past, the state was able to avoid financial losses by rejecting inferior merchandise that failed laboratory tests.

We recommend that the standards and engineering activity be reestablished in the Procurement Division. In the long run, this activity has excellent potential for saving the state much more money than it would cost. For example, completing the implementation of an energy efficient procurement program would save money for the state. Furthermore, this can be accomplished without increasing the division's current budget, if local purchasing authority is increased as we recommend. In effect, the combined effect of our recommendations would result in a smaller division budget as well as an improved ability to do value analysis and life cycle costing.

C. OTHER PURCHASING ISSUES

During our study, we also reviewed a number of other purchasing issues. Regarding issues that were raised in previous studies, we find that:

- The Procurement Division has improved its handling of agency complaints and has taken appropriate steps in cases in which vendors repeatedly provide inferior merchandise or services.
- Central Stores should continue to warehouse office supplies since it provides good service at a competitive price.
- The benefits of computerizing the state's purchasing operations may not justify the costs.

We also recommend a number of actions on issues not covered in previous studies:

- Division management needs to review inspection activities because the inspector position has been underutilized and inspection activities lack adequate direction.
- Past purchase orders should be reviewed at least once every two years to determine if these individual transactions can be consolidated.
- Division management should develop quantitative performance measures for buying personnel.



INTRODUCTION

This report is divided into four chapters. Chapter I provides an overview of state purchasing and the Procurement Division of the Department of Administration.

Chapter II evaluates whether the current degree of centralization of purchasing authority is cost effective. In particular, we examine whether the delegation of purchasing authority to state agencies should be increased. We also evaluate the cost effectiveness of the central warehousing of state office supplies.

Chapter III analyzes the efficiency and effectiveness of the Procurement Division as the state's central purchasing agent. In this chapter, we examine a number of issues relating to the division's performance.



I. AN OVERVIEW OF STATE PURCHASING

This chapter provides a brief overview of state purchasing activity. Because the Procurement Division of the Department of Administration controls nearly all purchasing by state agencies, we focus on the division's responsibilities, workload, and staffing.

A. RESPONSIBILITIES OF THE PROCUREMENT DIVISION

The Procurement Division's chief responsibility is to purchase supplies, equipment, construction materials, and certain services needed for the operation of state government. The division controls the purchasing activity of all state agencies and institutions with the exception of the legislative and judicial branches and the University of Minnesota.

The nature of the Procurement Division's purchasing responsibilities depends on the type of transaction. There are basically three different types of transactions: (1) purchase orders, (2) contract purchases, and (3) agency local purchases.

Purchase orders must be issued by the Procurement Division. The division's staff is responsible for soliciting and evaluating bids for items that an agency has requisitioned.

Contract purchases are generally made directly by state agencies but the Procurement Division is responsible for awarding the contracts.² Division staff must decide what types of commodities or services should be bought on contract rather than through individual purchase orders. In addition, the staff must write the specifications for the contract, solicit bids, and award the contract.

Finally, agencies are permitted to make certain purchases directly from vendors. The conditions under which local or delegated purchases can be made are determined by the Procurement Division. In addition, the division monitors local purchases to ensure compliance with its regulations. Local purchases are restricted to items that are

¹Additional exceptions include, but are not limited to, highway construction and maintenance work under the jurisdiction of the Commissioner of Transportation and maintenance services for recreational facilities under the control of the Commissioner of Natural Resources.

²About 90 percent of the contract purchases are made directly by agencies. Purchases of equipment with a unit cost of \$50 or more ("Group 4" items), however, must be made through the Procurement Division.

not available from contracts or the state's office supply warehouse, Central Stores. The division further restricts local purchases by setting a dollar limit on the amount that an agency can spend on any local purchase.

From an agency perspective, there is a fourth type of purchase. Purchases of paper, forms, and office supplies from Central Stores can be made directly by agencies without the Procurement Division's assistance. The division is responsible, however, for establishing the contracts from which Central Stores purchases its inventory.

Purchase orders account for the largest share of the state's purchasing volume. Almost 50 percent of state purchasing in fiscal year 1980 was accomplished by individual purchases made directly by the Procurement Division. Approximately 28 percent of the purchases were made from contracts established by the division. Finally, about 22 percent was made directly by state agencies operating under the regulations established by the division.³ Table 1 details the dollar volume of purchases over the last five fiscal years.

It should be noted that in making purchases the division is generally required by law to obtain competitive bids and make purchases from the lowest responsible bidder. On expenditures exceeding \$5,000, sealed bids must be solicited by public notice at least seven days before the close of bidding. On smaller expenditures, purchases can be made upon obtaining competitive bids or in the open market. However, if practical, three competitive bids should be obtained and permanently recorded.⁴

Two exceptions to these competitive bidding requirements are purchases from socially or economically disadvantaged persons and sheltered workshops. In these instances, the Procurement Division may pay up to five⁵ percent more than the estimated market price of goods and services.

The Procurement Division has a number of additional responsibilities related to its purchasing activities. First, it is responsible for establishing product standards and specifications. One purpose is to ensure that the state purchases a product which minimizes life-cycle cost, not just initial acquisition costs. For example, a product with sufficiently lower energy or maintenance costs may be

³Agency purchases from Central Stores are not itemized separately because purchases of inventory by Central Stores are included in the figures for contracts and purchase orders.

⁴Minnesota Statutes §16.07.

⁵The set-aside program for purchases from socially and economically disadvantaged persons is the subject of a separate report issued by the Program Evaluation Division.

TABLE 1
STATE PURCHASING ACTIVITY*

	Dollar Volume (in millions)				
	<u>FY 1977</u>	<u>FY 1978</u>	<u>FY 1979</u>	<u>FY 1980</u>	<u>FY 1981</u>
1. Purchase Orders	\$ 54.4	\$ 51.9	\$ 54.1	\$ 58.4	\$ 48.5
2. Merchandise Contracts	20.9	29.7	32.1	33.4	39.6
3. Agency Local Purchases	<u>31.3</u>	<u>31.9</u>	<u>28.4</u>	<u>26.2</u>	<u>Not available</u>
TOTALS	\$106.6	\$113.5	\$114.6	\$118.0	Not available

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Source: Department of Administration.

*These figures exclude construction contracts.

preferable to one with a lower initial price. Also, a product with a longer useful life may be less expensive in the long run than one with a lower price. Second, the Procurement Division performs inspections to verify that merchandise purchased is acceptable and complies with specifications. Finally, the division is responsible for promoting cooperative purchasing with other governmental units in Minnesota.

B. ORGANIZATIONAL STRUCTURE

The Procurement Division currently has a staff of 39. Most of the staff is organized into two groups of buyers each reporting to a senior buyer. Each buyer is responsible for the purchase of particular types of commodities and supervises an assistant. In addition to the two buyers groups, there are a pharmacist/buyer, merchandise contracts coordinator, inspector, small business coordinator, and a clerical pool. Figure 1 provides an organizational chart of the division.

The number of division staff has decreased by 13.5 positions from fiscal year 1981. Exactly 7.5 of the 13.5 positions were eliminated by the Department of Administration because of budget cuts made during the regular 1981 legislative session. This reduction was accomplished by eliminating the Standards and Engineering Section (4.5 positions) and three vacant clerical positions in the Buying Section.

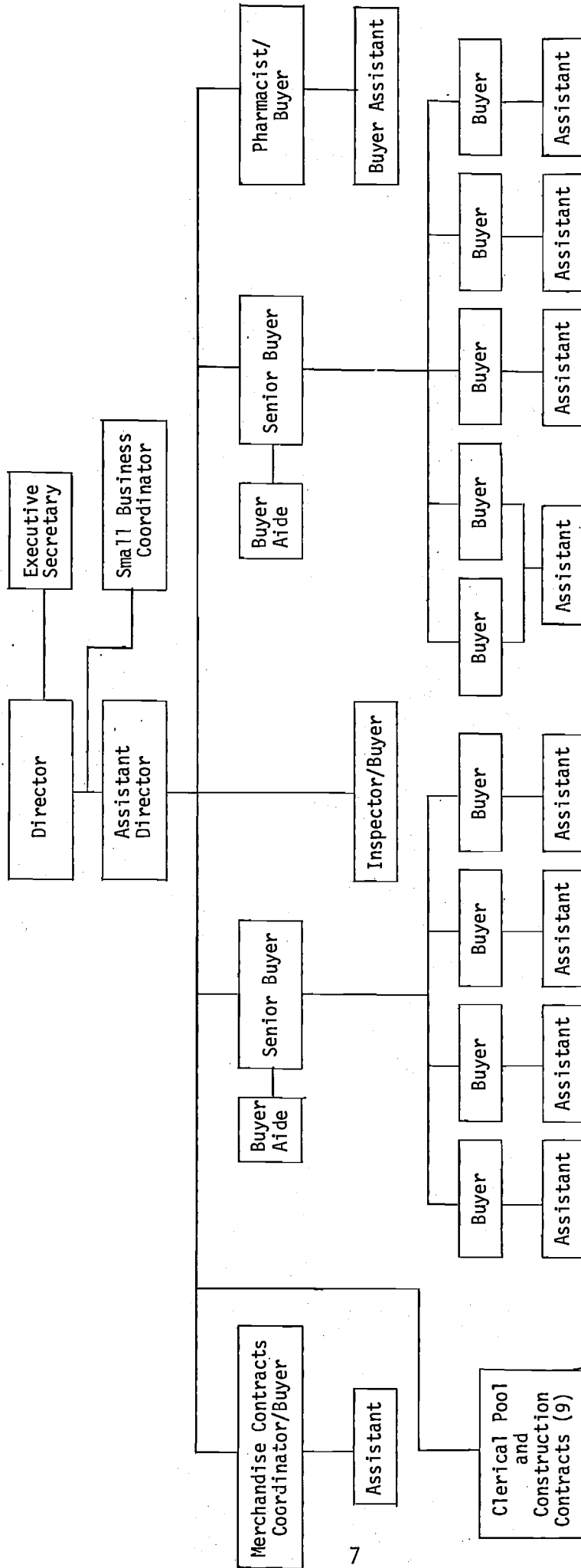
The other six positions cut can be explained as follows. First, a cut of three positions resulted from budget reductions made during the third special legislative session concluded in January 1982. The three positions eliminated were a buyer, a management analyst, and a secretary responsible for processing construction contracts. Second, state funding for a buyer assigned to the small business procurement program was only temporary. As result, this position was terminated after the funds were expended. Third, the division's staff complement was recently reduced by an additional two positions, including a secretary and a buyer assistant. This reduction was accomplished through attrition.

Of all these cuts, the elimination of the Standards and Engineering Section poses the greatest organizational problem. The question of whether the division's buyers will be able to carry out the responsibilities of the Standards and Engineering Section is discussed in Sections A and B of Chapter III. The elimination of most of the other positions was appropriate considering the Procurement

⁶The 4.5 positions include the Assistant Director for Standards and Engineering, a standards specialist, a vacant specifications writer position, a clerical position, and the part-time laboratory worker.

FIGURE 1

ORGANIZATIONAL CHART



Source: Procurement Division

Division's declining workloads in the areas of purchase orders and construction contracts. The division's staffing and workload are compared to those of central purchasing offices in other states in Section D of Chapter III. Terminating the management analyst position was appropriate since the responsibilities did not appear to require a full-time position. The management analyst was previously responsible for monitoring agency local purchases on a full-time basis. That responsibility has been since assigned to the assistant director.

II. CENTRALIZATION OF STATE PURCHASING

The responsibility for purchasing is highly centralized within state government. The Procurement Division of the Department of Administration is responsible for purchasing items costing as little as \$50.

This chapter evaluates whether the current degree of centralization is cost effective. In particular, we examine whether the delegation of authority to state agencies should be increased. In addition, we review whether the state should continue to have a central warehouse for office supplies.

A. PURCHASING AUTHORITY FOR STATE AGENCIES

State agencies are permitted to make certain purchases directly from vendors. The conditions under which local or delegated purchases can be made are determined, however, by the Procurement Division.

The division restricts local purchases to those items that are not available from state contracts or Central Stores. In addition, the division further restricts local purchases by setting a dollar limit on the amount that an agency can spend on any local purchase. Any purchase in excess of the limit must be made by the Procurement Division.

In general, local purchases of materials and supplies are limited to transactions of \$50 or less. There are some exceptions to this rule. If an agency has an immediate need for an item of \$300 or less, the agency may directly purchase the item. The quantities purchased must, however, be confined to just enough to continue operations until a further supply can be purchased by the Procurement Division. Some items such as repair parts and work and certain construction materials are subject to higher limits.¹ Proprietary repair parts, educational supplies, and subscriptions can be purchased directly without limit if available from only one vendor. Clothing and perishable foods can also be purchased directly without limit if not available from a state contract vendor.

In 1978, the Governor's Special Task Force on Procurement found that more than 50 percent of all purchase orders were for less than \$300. In addition, the task force found that the cost of processing small purchase orders likely exceeded any possible savings gained by processing them through the Procurement Division. As a result, the task force recommended that local purchases be permitted

¹The limits for repair work (parts and labor) and construction materials are \$500 and \$300 respectively.

up to \$50 without bids and up to \$300 with bids when there is an immediate need. It was also recommended that the limit on repair work be raised from \$200 to \$500.

Although the Procurement Division implemented these recommendations, there is good reason to believe that the changes have not worked as the task force believed they would. The task force believed that implementing their recommendations would result in more local purchases and a considerable reduction in the Procurement Division's workload.

However, a large percentage of the Procurement Division's workload continues to include small purchase orders. Based on a 10 percent random sample of purchase orders processed in fiscal year 1980, we estimate that 48 percent of the purchase orders were for \$300 or less. Sixty-one (61) percent of the purchase orders were for \$500 or less. Table 2 provides data on the estimated size of purchase orders processed by the Procurement Division during fiscal year 1980.

TABLE 2
PURCHASE ORDERS PROCESSED BY THE PROCUREMENT DIVISION
FISCAL YEAR 1980

<u>Value of Purchase Order</u>	<u>Estimated Percentage of Purchase Orders in Each Category</u>	<u>Estimated Cumulative Percentage of Purchase Orders</u>
\$100 or less	17.2%	17.2%
\$101 - \$200	19.4	36.6
\$201 - \$300	11.0	47.6
\$301 - \$400	7.8	55.4
\$401 - \$500	5.8	61.2
\$501 - \$1,000	14.4	75.6
\$1,001 - \$5,000	17.6	93.2
\$5,001 - \$10,000	3.4	96.6
\$10,001 or more	3.4	100.0

Source: Program Evaluation Division analysis.

Table 3 provides estimates of the percentage of purchase orders less than \$300 for the ten agencies that provide approximately 85 percent of the division's purchase order workload.²

TABLE 3
PURCHASE ORDERS BY STATE AGENCY

Agency	Estimated Percentage of All Purchase Orders	Percentage of Purchase Orders Less Than \$300
1. State Universities	20.5%	56.5%
2. Public Welfare	14.0	57.5
3. Transportation	9.7	36.1
4. Community Colleges	9.4	49.8
5. Corrections	9.3	41.0
6. Natural Resources	7.3	31.0
7. Administration	6.1	55.1
8. Economic Security	3.9	43.4
9. Public Safety	3.0	40.2
10. Health	2.3	43.9
Subtotal	<u>85.5%</u>	<u>48.1%</u>
Other Agencies	<u>14.5</u>	<u>44.8</u>
TOTALS/AVERAGES	100.0%	47.6%

Source: Program Evaluation Division analysis.

²The division's overall workload decreased significantly during fiscal year 1981. However, this decrease is due primarily to the general reduction in agency budgets and the spending freeze imposed during fiscal year 1981. This reduction does not appear to have significantly changed the distribution of purchase orders from that shown in Table 2.

Furthermore, our detailed analysis of purchase orders substantiates the task force's finding that the cost of processing small purchase orders exceeds any possible savings. Based on a random sample of 300 purchase orders of \$500 or less, we found that:

- Agencies recommended vendors to the Procurement Division on 96 percent of the requisitions and the division awarded the purchase to the agency recommended vendor in 75 percent of these cases.
- The specifications prepared by the agency were modified by the Procurement Division in only 6 percent of the cases.
- In at least 24 percent of the cases, the items purchased were proprietary and the Procurement Division contacted only one vendor anyway.

These findings indicate that processing requisitions of \$500 or less through the Procurement Division has little impact on purchasing decisions.

The Procurement Division has sometimes estimated the savings resulting from central processing by comparing the final price of a purchase order to the price estimated by the agency on its requisition. The method is questionable, however, since the estimates submitted by agencies are not generally accurate. Agencies have no particular incentive to provide accurate estimates under current regulations.

Nonetheless, we reviewed the relationship of the estimated price to the final price. Of the 300 cases examined, there were 126 instances in which the final price was lower, 125 cases in which the estimated price was lower, and 49 cases in which the two prices were the same. On average, the final price was \$4.04 lower than the estimate. However, if requisitions between \$400 and \$500 are excluded, the estimate was lower than the final price by \$0.59 on average.

A somewhat better method of identifying possible savings is to focus on those cases in which (1) the Procurement Division did not select the vendor recommended by the agency and (2) the final price was lower than the estimate. It is likely that no savings resulted from the division's processing of the purchase order if the agency's recommended vendor was selected.

Of the 283 requisitions of \$400 or less, only 43 fall into this category. If the savings on these purchase orders, as measured by the difference between final and estimated prices, is averaged over the 283 cases, savings amount to only \$5.28 per purchase order. Since the average cost of processing a purchase order is probably between \$20 and \$25, it is clearly inefficient for the Procurement Division to continue to process these relatively small purchase orders.

This point can also be illustrated by comparing the percentage of purchase orders under \$500 to the percentage of purchasing dollars they represent. Table 4 shows that while 61.2 percent of the purchase orders processed by the division are for \$500 or less, they represent only 4.9 percent of the purchasing volume.

TABLE 4
COMPARISON OF PURCHASING VOLUME TO
NUMBER OF PURCHASE ORDERS

<u>Value of Purchase Order</u>	<u>Cumulative Percentage of the Number of Purchase Orders</u>	<u>Cumulative Percentage of the Purchasing Volume</u>
\$100 or less	17.2%	0.5%
\$101 - \$200	36.6	1.6
\$201 - \$300	47.6	2.7
\$301 - \$400	55.4	3.9
\$401 - \$500	61.2	4.9
\$501 - \$1,000	75.6	9.1
\$1,001 - \$5,000	93.2	25.0
\$5,001 - \$10,000	96.6	34.7
\$10,001 or more	100.0	100.0

Source: Program Evaluation Division analysis of random sample of FY 1980 purchase orders.

Furthermore, it appears that most other states recognize the inefficiency of processing small purchase orders centrally. Tables 5 and 6 show that in 1979, most other states delegated purchases of at least \$500 to state agencies. Those states even include some which have greater computerization of their central purchasing operations than Minnesota. Thus, it appears that even computerization may not reduce central processing costs enough to justify handling small purchase orders centrally.

TABLE 5
LOCAL PURCHASING LIMITS IN OTHER STATES

State	Maximum Local Purchase*	State	Maximum Local Purchase
Alabama	\$ 100	Nebraska	\$ 35
Alaska	300	Nevada	500
Arizona	5,000	New Hampshire	100
Arkansas	750	New Jersey	1,000
California	500**	New Mexico	250
Colorado	50	New York	1,500
Connecticut	200	North Carolina	1,500
Delaware	2,000	North Dakota	100
Florida	2,500	Ohio	400
Georgia	500	Oklahoma	500
Hawaii	No maximum	Oregon	500
Idaho	***	Pennsylvania	300
Illinois	200	Rhode Island	50
Indiana	50	South Carolina	1,500
Iowa	150	South Dakota	500
Kansas	500	Tennessee	200
Kentucky	1,000	Texas	500
Louisiana	500	Utah	100
Maine	100	Vermont	100
Maryland	200	Virginia	500
Massachusetts	500	Washington	300
Michigan	400	West Virginia	1,000
Mississippi	100	Wisconsin	3,000
Missouri	200	Wyoming	1,000
Montana	150		

Source: Survey of Selected Procurement Practices of State Governments, Council of State Governments, 1979.

*States were asked to respond to the following question: "What is the usual dollar amount below which agencies are authorized to obtain their own quotations locally?"

**The limit in California was raised from \$100 to \$500 after the 1979 survey was conducted.

***Some agencies are given authority of \$1,000, \$2,500, or \$5,000. There is no requirement to receive bids but certain requirements, including monthly reports, have to be met.

TABLE 6
SUMMARY OF LOCAL PURCHASING LIMITS IN OTHER STATES

<u>Maximum Local Purchase</u>	<u>Number of States</u>
Less than \$100	4
\$100 - \$199	9
\$200 - \$299	6
\$300 - \$399	3
\$400 - \$499	2
\$500 or more	<u>25</u>
TOTAL	49

Source: Survey of Selected Procurement Practices of State Governments, Council of State Governments, 1979.

As a result, we make the following recommendations:

Recommendation: Authority for local purchases should be raised to \$500 with three informal bids required where practicable. Agencies should be permitted to obtain bids either by telephone or in writing. Items under \$50 would need only one quote. The authority for local purchases should be expanded to include "group 4" items (equipment with a unit cost of \$50 or more).³

Recommendation: This new general limit, as well as those special limits for items such as repair work, should be adjusted for inflation at least once every two years.

³This is very similar to the recommendation made by the Procurement Advisory Committee in October 1979 but not implemented by the Procurement Division. Our recommendation differs in that local purchases would be limited to those items not available from state contracts or Central Stores. The committee suggested that the purchase of contract items from non-contract vendors be permitted if equal quality, equivalent delivery, and a substantial price savings could be obtained.

Implementation of these recommendations should be accomplished by the Department of Administration. However, if the department does not make the recommended changes, the Legislature should consider statutory changes.

As in the past, the use of this increased purchasing authority should be optional for each agency. Purchasing staff in most state agencies indicated to us that their agency would utilize the increased purchasing authority and that it would not require additional staff resources in their agency.

The Procurement Division should continue to monitor agency local purchases as in the past. However, we believe more emphasis should be placed on ensuring that agencies are soliciting competitive bids. In the past, the division generally reviewed local purchases only for compliance with its procedural regulations. In addition, the division should not attempt to review every local purchase as in previous years. Division staff should "spot-check" agency compliance and solicitation of bids rather than reviewing each individual purchase. This responsibility should require no more than half of one individual's time.

The division should be prepared to withdraw its approval of local purchasing authority for any agency that repeatedly abuses that authority but takes no steps to end the abuse. This has not been necessary in the past because of the limits placed on local purchasing authority and the lack of any serious problems with agency compliance.

Implementation of our recommendations could save the state up to \$400,000 each biennium depending on how many agencies use their increased authority. The principal savings would be in the Procurement Division's personnel costs. Some paper and mailing costs would also be reduced. Department of Finance officials indicate that the recommendations would also save some personnel costs in their department due to a significant reduction in the number of accounting transactions. In addition, reductions in agency inventories may be possible because it would take less time to make purchases. Savings in the form of reduced carrying costs would then be realized but are difficult to estimate with accuracy. Some additional administrative costs may be incurred by state agencies doing more of their own purchasing. However, these costs will likely be minimal and can be absorbed by agencies within their current budgets.

B. CENTRAL STORES

Both the Governor's Special Task Force in 1978 and the Procurement Advisory Committee in 1979 made recommendations concerning Central Stores. The task force recommended reducing dependence on Central Stores and placing more emphasis on systems contracting as used by Hennepin County. Systems contracting permits

Hennepin County to avoid the expense of maintaining a central warehouse for office supplies. Instead, private vendors deliver supplies on a daily basis to county offices.

The Procurement Advisory Committee, however, recommended continued reliance on Central Stores. The Advisory Committee report found that Central Stores' prices, which include a charge for the cost of running Central Stores, compare favorably with those in Hennepin County. The committee also found that Central Stores provides a reliable service.

Our findings concur with those of the Procurement Advisory Committee. We found Central Stores' prices to be comparable to those paid by Hennepin County. In addition, both sets of prices are approximately half the retail prices for the same items. As a result, we recommend continued reliance on Central Stores for the warehousing and distribution of office supplies.

III. EFFICIENCY AND EFFECTIVENESS OF THE PROCUREMENT DIVISION

This chapter addresses a number of issues concerning the Procurement Division's performance as the state's central purchasing agent.

A. STANDARDS AND VALUE ENGINEERING

In 1972, a LEAP report recommended reorganizing the Procurement Division into two sections, Buying and Engineering. This change was intended to upgrade and emphasize the engineering functions of standards, specifications, inspection, and research. The primary reason for the recommendation was to improve the quality of goods purchased by the state.

In 1978, the Governor's Special Task Force recommended further upgrading and expansion of the Standards and Engineering Section. The task force intended for the Procurement Division to develop a capacity to do value analysis or life cycle costing. The task force report said that the Procurement Division placed too much emphasis on buying items that cost the least initially and not enough emphasis on providing service to state agencies. In particular the report said:

The lowest initial cost or price does not necessarily result in the best value to the state. If an expensive piece of equipment is broken down and out of use for a considerable period of time, the cost to the state may be far greater than any saving effected in its initial purchase. It cannot be said that paint which requires three coats to adequately cover represents a cost savings when a higher cost paint might do the job in two coats.

In 1979, the Procurement Advisory Committee recommended that a research office independent of, but advisory to, the Procurement Division be established. That office would provide a rigorous and systematic feedback on product maintenance, utility, and life span and implement value analysis or life cycle costing of products. In effect, the office would assume most of the responsibilities of the Standards and Engineering Section.

Despite the continued concern raised by these three reports, the use of value analysis or life cycle costing has never been utilized in the Procurement Division to any significant degree. The Department of Administration did not request and the Legislature did not appropriate funds in 1979 to upgrade and expand the activity as recommended by the Governor's Special Task Force. In 1981, the Department of Administration recommended to the Governor and the

Legislature that the Standards and Engineering Section be abolished and its functions transferred to the division's commodity buyers. As of July 1, 1981, the section was abolished.

In reviewing the history and work of the Standards and Engineering Section, we found a number of reasons why the section was never able to meet the goals established for it. For example:

- Past division management was not supportive of the section and its activities.
- The section lacked certain technical engineering expertise.
- Buyers lacked confidence in the analyses produced by the section.
- Some buyers never fully accepted the rationale for life cycle costing.
- There was a lack of cooperation between the engineering and buying sections.

However, there are sufficient reasons why this activity should be reestablished. For example:

- There is still a great need to improve the quality of products the state purchases. In the long run, this activity should be able to save the state more money than it would cost.
- Full implementation of an energy efficient procurement program was not achieved.
- Procurement's buyers can do certain market research and evaluation but generally do not have the technical expertise for value analysis or life cycle costing.
- Buyers indicate that they also lack the technical expertise in certain product areas to: (1) challenge agency designed specifications that may unnecessarily restrict competition, or (2) determine whether low bidders meet technical specifications.
- The standards and specifications committees for various products have been meeting less frequently and lack the leadership that would be the result of a successful standards and engineering section in the Procurement Division.

¹See the Report on the Reduction of State Labor Force, Department of Finance, March 1981, p. A-32.

Another very important factor is the recent change in division management. The new division director is very supportive of a standards and engineering activity. In our opinion, this is the key element that was missing in the past. As a result, we make the following recommendation:

Recommendation: The standards and engineering activity should be reestablished in the Procurement Division.

Given current fiscal constraints on the state, this can only be accomplished if local purchasing authority is increased as recommended in Chapter II. Since increasing local purchasing authority would likely save more money than the standards and engineering activity would cost, the combined effect of our recommendations would be a smaller division budget as well as an improved ability to do value analysis and life cycle costing.

It would be desirable to devote some additional resources to this activity even if, due to limited resources, its previous staffing level is not restored. The addition of even one or two qualified staff would be helpful.

B. INSPECTION AND TESTING

Inspection and testing are recognized as important elements of any purchasing operation. Inspection of products received by state agencies assures that suppliers deliver goods in the specified amounts and in conformance with product specifications. Laboratory testing of selected product samples can be used to verify compliance with technical specifications. According to the Council of State Governments, central purchasing offices in 26 states have inspectors to assist or supplement agency personnel. Central purchasing offices in 34 states² have a product testing program or use product testing procedures.²

In 1972, a LEAP report recommended placing the inspection and testing functions within the proposed procurement engineering section. The report also suggested that the inspection work being done by the Procurement Division required more than a part-time inspector. Since then, the division has had a full-time inspector responsible for (1) inspecting deliveries made to the division, (2) conducting inspections of deliveries made to other state agencies, and (3) reviewing the inspection work done by designated personnel of other state agencies.

² Survey of Selected Procurement Practices of State Government, Council of State Governments, 1979, p. 31.

Until recently, the division also had a limited capacity to perform laboratory analyses of products that were suspected of failing to meet contract specifications. The laboratory was staffed by a part-time student employee who reported to the assistant director for standards and engineering. Despite the lack of resources, the testing program enabled the division to reject some inferior merchandise that was supplied to the state. Funding for the laboratory was terminated as of July 1, 1981, along with the Standards and Engineering Section.

1. INSPECTION

In reviewing the division's inspection activities, we find the following problems:

- The full-time inspector's position is underutilized.
- Inspection activities lack adequate direction.
- Procedures required in the division's Quality Control and Inspection Manual for the recording of complaints received, inspections made, and actions taken are not followed by the division's inspector.

These findings are discussed below in detail.

For the last several years, the inspector has been spending only about 25 to 30 percent of his time in the field performing inspections and discussing purchasing problems with agency personnel. According to the inspector, a reduction in the budget for travel is the main reason his field time has been limited. His remaining time has been filled by writing inspection reports, following up complaints on a limited basis, and discussing purchasing procedures or problems with agency purchasing personnel over the telephone.

It is clear from a review of the inspector's activities and responsibilities that this position has been underutilized. As a result, we recommend the following:

Recommendation: Division management should either increase the inspector's field time or assign additional responsibilities to the inspector.

Since the inspector's position is already classified as an Inspector/Buyer II, the inspector could be assigned responsibility for the purchase of certain commodities. Alternatively, the inspector could be assigned the responsibility of reviewing local purchases and be available to fill in as needed for buyers who are on leave.

The inspection activities also lack adequate direction. The inspector has attempted to visit each state agency or institution once per year. However, this type of inspection routine fails to target for

inspection those agencies or products for which inspection by the central purchasing office would likely be most productive. The routine doesn't involve consideration of the volume of purchasing done by each agency or institution or current or past evidence of merchandise problems. Inspections focus on the most recently received merchandise, regardless of its dollar value or the need for an additional inspection besides the one done by the receiving agency. In addition, because the agencies are not contacted prior to most inspections, the inspector has experienced numerous problems in completing inspections. Key agency personnel are frequently not in the office when the inspector arrives.

In summary, the limited resources available for inspection activities are not utilized in an efficient manner. We recommend:

Recommendation: Division management should review inspection activities and set priorities and determine procedures for future inspections.

Finally, we find that established procedures for recording of complaints received, inspections made, and actions taken by the inspector are not being followed. The division's Quality Control and Inspection Manual requires the inspector to complete a daily summary report entitled "Daily Summary Report of Inspections Made and Actions Taken" (Form 591). The inspector does not, however, use this form. Instead, reports on inspections are made in memoranda that provide a great deal of information about conversations with agency personnel but sometimes omit more important information on the inspections made.

In addition, the inspector does not follow the established procedure for recording and reporting complaints brought to his attention by state agencies. The division's manual requires the inspector to report all cases of non-compliance with specifications or unsatisfactory service brought to his attention using the "Purchasing Complaint Report" (Form 572). Although complaints are sometimes discussed in the memoranda previously mentioned, often no formal complaint form is completed. The failure to report all complaints weakens the division's ability to periodically monitor and evaluate the performance of vendors. As a result, we make the following recommendation:

Recommendation: The inspector should report the results of his inspections on Form 591 and all complaints received on Form 572.

2. TESTING

Since funding for the Standards and Engineering Section and the laboratory was eliminated in July 1981, the Procurement Division has not had a testing program. Furthermore, the division has no clear plans for dealing with products that they suspect fail to meet specifications but require laboratory testing to substantiate their

suspicion. Although it would be possible to obtain the services of an outside testing firm, division resources for this alternative are quite limited. The inspector has collected samples of some products that may need testing, but has not received directions regarding the use of laboratory facilities. The division also lacks the technical expertise to determine in which situations a laboratory analysis would be productive.

One solution would be to reestablish a testing program along with the standards and engineering activity. An alternative would be to consider whether a testing program could utilize the resources of state colleges, universities, or technical schools. According to the Council of State Governments, this latter alternative is used in a number of other states.

Recommendation: Department and division management should establish both a short-term and a long-term solution to the current lack of funding for procurement laboratory testing.

Clearly, this will require some additional resources to be allocated to testing. However, a fraction of the savings from the recommended increase in local purchasing authority could be used to fund the testing program.

C. CONSOLIDATION OF PURCHASES

An important function of a central purchasing office is to create state contracts where purchases of state agencies can be consolidated. Contracts may be created for a specific commodity for one agency or they may consist of one or several different items available to several or all state agencies. Contracting enables the using agency to purchase directly from the vendor instead of going through the requisition process. Contracting reduces administrative costs, provides convenience to agencies, and results in lower prices because of volume buying. Contracts are usually worthwhile when the number of requisitions for a particular product or group of similar products is high and the dollar volume of purchases exceeds \$5,000.

The Procurement Division has generally done a good job in consolidating state purchases. In fiscal year 1980, the division had 415 merchandise contracts in effect. However, we found that the division does not have information on purchase order or local purchase volume of particular commodities. This information could be used to assist the division in establishing additional merchandise contracts where justified by purchasing volume.

Currently, the division has multiple sets of requisitions and purchase orders. However, these are all filed by state agency, not by commodity.

Recommendation: At least once every two years, the Procurement Division should review past purchase orders to determine if individual agency transactions can be consolidated.

Division management should also determine whether any of its sets of records of requisitions and purchase orders should be filed by commodity to facilitate such a review.

D. PRODUCTIVITY

Over the last four years, there has been a general reduction in the division's buying workload. The number of purchase orders issued by the division has declined by more than 40 percent over the last four years. Most of this decline can be traced to reductions in agency budgets. The number of merchandise contracts increased by 21 percent between fiscal year 1977 and fiscal year 1980. However, the number of contracts was at approximately the same level in fiscal year 1980 as in fiscal year 1974. Furthermore, processing requisitions and purchase orders is a greater factor in the division's workload than merchandise contracts.

Despite this general reduction in workload, the number of personnel assigned to buying activities has not declined as much. Currently the Procurement Division has 33 staff (13 buyers, 12 buyer aides or assistants, and 8 clerical staff) involved in processing requisitions and purchase orders and establishing merchandise contracts. The number of ³staff involved in buying activities is down from 39 in previous years.

In addition, the division's staff size appears to be high considering its workload when compared to other states. Using figures compiled by the Council of State Governments for fiscal year 1978, we compare in Table 7 the ratio of workload to staff size for the 50 states. Workload is measured by the total dollar volume of purchases made and contracts awarded through each state's central purchasing office.

In fiscal year 1978, Minnesota's purchasing volume was below the national median of \$100,000,000. Its staffing level was above the national median of 35.5. Minnesota's ratio of dollar volume to number of staff, \$1.7 million per staff member, was tied for 42nd place among the 48 states that provided the necessary information. Recent staff reductions would probably increase Minnesota's ranking. However, it would still be below the 1978 median of \$2.7 million per staff member.

³Buying staff involved with construction contracts or the set-aside program are excluded from these totals.

TABLE 7

RATIO OF PURCHASING VOLUME TO NUMBER OF STAFF:

FISCAL YEAR 1978

State	Ratio *	State	Ratio	State	Ratio
Alabama	\$3.1 million	Louisiana	\$1.6 million	Ohio	\$4.3 million
Alaska	2.7	Maine	1.6	Oklahoma	3.3
Arizona	2.1	Maryland	2.6	Oregon	3.1
Arkansas	1.3	Massachusetts	3.2	Pennsylvania	2.2
California	2.5	Michigan	2.1	Rhode Island	2.3
Colorado	3.0	MINNESOTA	1.7	South Carolina	2.2
Connecticut	1.9	Mississippi	NA	South Dakota	3.5
Delaware	NA	Missouri	2.7	Tennessee	1.8
Florida	5.9	Montana	2.4	Texas	10.0
Georgia	4.2	Nebraska	3.7	Utah	7.2
Hawaii	1.1	Nevada	1.2	Vermont	3.1
Idaho	2.4	New Hampshire	2.1	Virginia	3.1
Illinois	2.1	New Jersey	2.7	Washington	1.7
Indiana	2.3	New Mexico	11.8	West Virginia	7.2
Iowa	3.0	New York	3.2	Wisconsin	10.4
Kansas	3.4	North Carolina	3.3	Wyoming	3.8
Kentucky	2.8	North Dakota	2.1		
	Median Ratio = \$2.7 million		Median Purchasing Volume = \$100.0 million		Median Staff Size = 35.5

Source: Compiled from data in the Survey of Selected Procurement Practices of State Governments, Council of State Governments, 1979, p. 66.

*The ratio is dollar volume purchased (in millions) divided by the number of staff. The dollar volume includes purchases made and contracts awarded through the central purchasing office, excluding construction and services. The number of staff in the central purchasing office includes administrators, buyers, specification and testing personnel, inspectors, and related clerical staff.

In part, Minnesota's ranking is low because most other states delegate more purchasing authority to state agencies. In addition, other states have generally computerized their purchasing operations more than Minnesota.

However, these factors do not explain all of the difference in productivity. In light of these findings, we make the following recommendation:

Recommendation: Division management should develop quantitative performance measures for buying personnel.

We recognize that performance should not be measured only in quantitative terms. Qualitative aspects of performance are of at least equal importance. However, as workload declines, division management must be prepared to make staffing decisions. To make those decisions objectively, management needs some quantitative measure of the amount of work that can be expected per staff member assigned to the buying activity.

E. COMPLAINT HANDLING

In previous studies, the division's handling of complaints received from state agencies has been the subject of concern. The Governor's Special Task Force recommended that the complaint handling system be revised to ensure that all complaints were logged in and resolved promptly. It was also recommended that the division enforce vendor compliance with purchase terms by more frequently charging vendors with the cost of substitute purchases and removing them from the bidders list. The Procurement Advisory Committee made a number of recommendations concerning specific products. For example, the committee recommended that the quality of staples, correcting fluid, and typewriter ribbons purchased by Central Stores be improved. It was also recommended that the division investigate using multiple prices for items for which delivery delays were lengthy. A higher price would be paid by an agency requiring quicker delivery than required in the division's existing contract with the vendor.

Table 8 shows that the most frequently received complaint is that merchandise is inferior and doesn't meet specifications. This complaint is more frequent for purchases from Central Stores than for other purchases. Late delivery is the next most frequent complaint for purchases from private vendors, but not at all a problem for Central Stores.

The total number of complaints received is not, however, excessive. In fiscal year 1980, 528 written complaints were received. These included 401 complaints about private vendors and 127 complaints about Central Stores. Considering the total volume of purchasing, the number of complaints is minimal.

TABLE 8
NATURE OF COMPLAINTS:
FISCAL YEAR 1981

Category	Percentage of Complaints Concerning:		
	Private Vendors	Central Stores	Combined Total
1. Inferior merchandise	23.0%	65.7%	38.4%
2. Late delivery	21.7	--	13.9
3. Replacement requested	6.3	29.0	14.5
4. Vendor will not deliver	4.7	0.6	3.2
5. Procurement's specifications are incorrect	3.7	--	2.3
6. Short weight	2.0	--	1.3
7. Different brand substituted	2.0	--	1.3
8. Overshipment	1.6	--	1.1
9. Improperly labeled	1.3	--	0.8
10. Damaged shipment	1.0	--	0.6
11. Grade or inspection evidence missing	0.6	--	0.4
12. Purchase order not yet issued by Procurement	0.3	--	0.2
13. Other	<u>31.8</u>	<u>4.7</u>	<u>22.0</u>
TOTALS	100.0%	100.0%	100.0%

Source: Program Evaluation Division analysis of complaint files.

Furthermore, the total number of complaints has declined from 528 in fiscal year 1980 (44 per month) to 379 in fiscal year 1981 (32 per month) and to 75 in the first five months of fiscal year 1982 (15 per month). While some decline is probably due to a general reduction in the volume of purchasing, we believe that an improvement in the division's responsiveness to complaints has also contributed to the decline in complaints. In fiscal years 1980 and 1981, 78 percent of the complaints about Central Stores concerned only three items. The contract with the vendor supplying one of the items was cancelled. A second item was removed from the acceptable brands list. The sheltered workshop that supplied the third item replaced all the defective merchandise initially received by the state.

The division took similar actions in most cases not involving Central Stores. As a result, we conclude that the division has improved its performance in this area. We encourage the division to continue to monitor and evaluate complaints and to take actions appropriate to each situation.

F. COMPUTERIZATION

In 1978, the Governor's Special Task Force recommended the development of a comprehensive computer system for the procurement process with links to inventory management and vendor payment systems. The task force estimated that such a system might cost as much as \$300,000 to \$400,000, but believed that it would be well worth its cost over the long term. The principal benefit mentioned by the task force was a reduction in the amount of time taken to handle requisitions. If the amount of time was reduced, agency inventories and the resulting carrying cost of inventories would be lowered. Other potential benefits include: (1) a reduction in paperwork and thus in staffing in the Procurement Division and possibly in state agencies, (2) lower bid prices on merchandise contracts due to the availability of past purchase figures, and (3) additional volume discounts obtained because the division can more easily determine what additional merchandise contracts should be established.

In July 1979, the Department of Administration completed an initial study of a computerized procurement system. The report outlined some general and specific requirements for a system and listed various types of computer reports that would be required in order to be useful to the division. The report stopped short of recommending specific action but estimated that it would cost about \$500,000 to develop and about \$250,000 annually to operate the system. No subsequent action was taken on the report.

Minnesota's procurement process is clearly less computerized than many other states. Only drug and pharmaceutical purchasing is computerized. In contrast, most other states have computerized one or more aspects of the general procurement process.

We do not, however, recommend any particular action in this area. Most other states we talked with did not report any significant net savings in personnel costs as a result of computerization. In addition, we doubt that computerization alone would significantly reduce processing time for requisitions. The largest component of processing time is the time it takes vendors to respond to the division's solicitation of bids. This component is unlikely to be affected by computerization. Other possible benefits from computerization are difficult to quantify. As a result, it is difficult to determine whether computerization would pay for itself. We encourage the Department of Administration and the Procurement Division to continue to see if any existing software packages could be adapted for Minnesota's use at a more reasonable cost. However, we remain skeptical that the benefits would justify the costs.

STUDIES OF THE PROGRAM EVALUATION DIVISION

Final reports and staff papers from the following studies can be obtained from the Program Evaluation Division, 122 Veterans Service Building, Saint Paul, Minnesota 55155, 612/296-8315.

1977

1. Regulation and Control of Human Service Facilities
2. Minnesota Housing Finance Agency
3. Federal Aids Coordination

1978

4. Unemployment Compensation
5. State Board of Investment: Investment Performance
6. Department of Revenue: Assessment/Sales Ratio Studies
7. Department of Personnel

1979

8. State-sponsored Chemical Dependency Programs
9. Minnesota's Agricultural Commodities Promotion Councils
10. Liquor Control
11. Department of Public Service
12. Department of Economic Security, Preliminary Report
13. Nursing Home Rates
14. Department of Personnel, Follow-up Study

1980

15. Board of Electricity
16. Twin Cities Metropolitan Transit Commission
17. Information Services Bureau
18. Department of Economic Security
19. Statewide Bicycle Registration Program
20. State Arts Board: Individual Artists Grants Program

1981

21. Department of Human Rights
22. Hospital Regulation
23. Department of Public Welfare's Regulation of Residential Facilities for the Mentally Ill
24. State Designer Selection Board
25. Corporate Income Tax Processing
26. Computer Support for Tax Processing

27. State-sponsored Chemical Dependency Programs, Follow-up Study
28. Construction Cost Overrun at the Minnesota Correctional Facility - Oak Park Heights
29. Individual Income Tax Processing and Auditing
30. State Office Space Management and Leasing

1982

31. Procurement Set-Asides
32. State Timber Sales
33. Department of Education Information System
34. State Purchasing

In Progress

35. Fire Inspections of Residential Facilities for the Disabled
36. State Mineral Leasing
37. Post-Secondary Vocational Education
38. Direct Property Tax Relief Programs