REPORT TO

UTAH STATE LEGISLATURE

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A Performance Audit of Central Stores

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Digest of a
Performance Audit of Central Stores

Central Stores (Stores) was created in 1975 as an internal service fund for the purpose of providing basic office supplies to state agencies on a cost recovery basis. Central Stores has historically purchased these supplies from vendors in bulk, provided warehouse and delivery for state agencies in the most economical manner possible, and then billed agencies for these services. While Stores has traditionally operated in that manner, they are now in the process of a complete change. Central Stores has recently negotiated a vendor-direct or "stockless" office supplies contract which eliminates the need for a central warehouse and delivery system, and consequently plans to cease its current operations. As of the writing of this report, the Division of Purchasing and General Services is working towards full implementation of this contract and plans to close operations at Stores by October 1997.

We agree with the plans to eliminate Central Stores. The move to a stockless office supplies contract will be positive for the state, primarily because supplies will cost less for state agencies while delivery time and service should improve. The traditional functions for which Stores was created—buying in bulk and warehousing product, receiving, filling and delivering orders, billing customers, and providing customer service—can all be handled more efficiently and effectively directly through the private sector. In fact, we feel the prices and service available from the state contract are such that many political subdivisions throughout the state may benefit from using the contract.

The following summarizes the main findings of our report:

Stockless Contract Makes Central Stores Obsolete. Because of current capabilities in the private sector and a new office supplies contract negotiated by the Division of Purchasing and General Services (Purchasing), the Central Stores operation has become functionally obsolete. A "stockless" contract is being developed which will allow state agencies to order and receive merchandise directly from the office supply vendor under contract. This means the state will no longer need to warehouse and deliver products, and the elimination of Stores will save the state approximately $500,000 annually. Although Stores has traditionally procured supplies from several vendors under contract, these contracts have largely been consolidated and all supplies will now be provided directly to state agencies on a stockless basis. We believe this new stockless contract is a positive move because, overall, office supplies will cost less to state agencies and it will provide a more direct and efficient system of product ordering and delivery. In addition, nearly every other state we contacted procures office supplies on a stockless basis, and reports that they are very satisfied with this type of a vendor-direct system. We recommend that Purchasing notify all state agencies of the benefits of the new state contract and make them aware that all purchases can be made directly from the office supplies vendor. In addition, Purchasing should inform state agencies that the historical concerns some users have had with Central Stores regarding pricing and service issues should be eliminated by using a vendor-direct system.

Political Subdivisions May Benefit From the New State Contract. In addition to saving money and improving service for state agencies, the new stockless office supplies contract may provide similar benefits to the state's political subdivisions including higher education institutions, public school districts, and local governments. Although it was not specifically part of the audit request, we briefly reviewed the office supply purchasing practices of political subdivisions. Our analysis indicates that some higher education institutions can immediately benefit from the pricing under the new contract. Also, we believe that school districts may benefit from using the stockless contract and should evaluate their current costs of office supply procurement and compare these with the new contract prices. In addition, our discussions with one city suggest that local governments can also benefit from using the new state contract. We recommend that Purchasing inform political subdivisions of the prices and service available to them through the state contract and encourage each one to evaluate whether they would benefit from using the contract. Each political subdivision may have varied needs and circumstances, but the stockless office supply industry is now well enough developed in Utah that each subdivision should evaluate the benefits of using the stockless contract as compared to current methods of office supply procurement.

Chapter I
Introduction

Central Stores (Stores) was established in 1975 as an internal service fund to provide basic office supplies to state agencies on a cost recovery basis. Central Stores was created for the purpose of purchasing these supplies in bulk, providing warehouse and delivery to state agencies in the most economical manner possible, and then billing agencies for these services. While Stores has traditionally operated in that manner, they are now in the process of changing directions altogether. Central Stores has recently negotiated a vendor-direct or “stockless” office supplies contract which eliminates the need for a central warehouse and delivery system. Consequently, Stores plans on ceasing current operations by October 1997.

We agree with the plans to eliminate Central Stores. The move to a stockless office supplies contract will be a positive step for the state, primarily because supplies will cost less for state agencies while delivery time and service should be improved. The traditional functions for which Stores was created—buying in bulk and warehousing product, receiving, filling and delivering orders, billing customers, and providing customer service—can all be handled more efficiently and effectively by the private sector as discussed in Chapter II. In fact, we feel the prices and service available from the state contract are such that many political subdivisions throughout the state may benefit from using the contract.

Central Stores Provides Basic Office Supplies

Central Stores, which is currently housed in the Division of Purchasing and General Services (Purchasing) in the Department of Administrative Services, exists to provide “state agencies, school districts and higher education an efficient and effective source of office supplies.” Central Stores supplies state agencies with items from pens, paper, staplers, and folders to furniture polish, paper towels, paper cups, and archive boxes. Currently, Stores still maintains a warehouse of approximately 9,000 square feet which is jointly located with Central Mail and the Division of Information Technology Services. Central Stores warehouses about 600 different items which are most frequently used by state agencies. Most of these items are supplied by one office supplies vendor, but some products are supplied to Stores from other vendors even though they are considered office supplies. Central Stores has developed separate contracts with other vendors for specific items such as paper, cleaning supplies, envelopes, and industrial paper (paper towels, toilet tissue, etc.) because traditionally these items have been procured more economically through other sources. Agencies place orders for office supplies through Stores which are either filled from warehouse stock or are individually “special ordered” from the appropriate vendor and sent to Stores. Items are then picked up by a contracted courier service and delivered to the requesting agency where payment is then made to Stores electronically through the state’s finance system. In an attempt to break even on their operating costs as an internal service fund, Stores adds a markup of between 18 percent and 30 percent to products.

In addition to orders filled through the warehouse, Central Stores also maintains small convenience stores in the Capitol building as well as in both the Ogden and Provo regional center buildings. These three outlet stores are located in areas where there is a high concentration of state agencies, and also stock basic items for immediate purchase. These three stores, however, only account for about 3 percent of Central Stores annual sales.

Sales Have Increased Over the Years

The following figure provides a history of financial and personnel data for Stores. As shown, sales revenues and expenses have been steadily on the rise.

Figure I
Central Stores Financial & Personnel Data

Fiscal Year	Total Sales	Total Expenses	Added to Retained Earnings	Inventory Value	FTEs†	Average Orders Processed Daily
FY97	$3,872,182	$3,922,373	($50,191)	$302,328	8.38	151.9
FY96	3,528,051	3,536,676	(8,625)	189,501	8.65	138.8
FY95	2,828,058	2,789,260	38,798	316,014	8.75	114.2
FY94	2,554,345	2,435,349	118,996	289,077	8.50	no data
FY93	2,421,813	2,421,019	794	301,454	8.50	no data
FY92	2,526,597	2,525,180	1,417	390,607	8.50	no data

† FTE = Full-Time Equivalent.

As Figure I shows, Stores had sales totaling $3,872,182 in FY 1997, and sales have increased on average about 9 percent annually over the last five years. The majority of revenues, about 53 percent, comes from the sale of Stores' warehoused items. Sales of special order items constitutes about 33 percent of the total, while paper sales equals about 13 percent of the total. Though paper is an item warehoused by Stores, it is segregated in its own category due to the volume of paper purchases.

On average, inventory values have decreased due to a management decision to consolidate the number of items stocked at the warehouse to only those most frequently used. (Currently, warehouse inventory levels are gradually being eliminated to accommodate the stockless system.) On the other hand, an average of about $17,000 has been added each year to retained earnings, which is basically the result of Stores trying to estimate revenues and expenses each year. Central Stores currently employs about 8.5 FTE's including a manager, an accounting technician, 4.5 permanent warehouse workers, and 3 temporary warehouse workers that are equivalent to about 1.8 FTEs. As shown, staffing levels have stayed relatively constant over the years. While the current Stores system will no longer exist in the future, Purchasing plans on retaining at least one staff person to be a "contract administrator" to oversee the stockless office supplies contract for the state. This contract administrator position is discussed further in Chapter II.

Product Markup Rates Vary

As an internal service fund, Stores has averaged a product markup of about 25 percent to recover the costs of order receiving, warehousing and delivery of products, billing, and providing customer service. The rates are actually different for each type of product sold and must be approved each year by the Legislature. Figure II below shows historical rate schedules for each product category.

Figure II
Historical Markup Rates

	FISCAL YEAR							
Product	**FY 90**	**FY 91**	**FY 92**	**FY 93**	**FY 94**	**FY 95**	**FY 96**	**FY 97**
Special Orders	20.0%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%	20.0%
Items Over $2*	18.0	22.0	22.0	22.0	25.0	25.0	25.0	25.0
Items Under $2*	23.0	30.0	30.0	30.0	30.0	30.0	30.0	30.0
Paper	15.3	18.0	18.0	18.0	18.0	18.0	18.0	18.0
Forms	**	25.0	25.0	25.0	35.0	35.0	35.0	35.0
Franklin Prod.	**	**	**	**	**	**	25.0	5.0

**** Products in these categories represent most of the items warehoused at Central Stores.***
***** No data available***

The "forms" category includes many specific printed forms used largely by the Department of Transportation, as well as generic forms used by various state agencies. With the elimination of Stores, the rate schedule above also becomes obsolete except for a planned

2 percent charge on all products ordered through the office supplies vendor to cover the cost of the "contract administrator."

Audit Scope and Objectives

This audit was initiated by the Legislative Process Committee who requested an in-depth budget review of Central Stores. As a Process Committee audit, Central Stores will also be reviewed by the Office of the Legislative Fiscal Analyst who will concentrate more exclusively on budget issues. The Office of the Legislative Auditor General previously audited Central Stores in 1985 (Report # 85-05), and the major findings were: 1) Central Stores needed better management direction, and 2) product pricing needed to become more competitive. If management were unable to correct these problems, the audit report concluded, the entire Central Stores function should be eliminated and replaced by a private vendor service.

Our primary objective in this audit was to evaluate whether a need still exists for the Stores operation or whether office supply procurement could best be handled through the private sector. As we began to see that Stores was undertaking significant changes which would ultimately lead to the operation being eliminated, we tried to evaluate the dollar effect this move would have in terms of how state agencies purchase office supplies. In addition, we conducted a brief review of the effect this new stockless contract could have for political subdivisions. In many ways this audit seemed to be "self-correcting," where solutions to issues of moving to a stockless system were generated along the way between the audit team and Stores personnel. Under the new system—which is discussed at length in the next chapter—issues of warehouse lease costs, inventory levels, and contracting for delivery will no longer exist since Stores will be eliminated and those functions will be handled directly by the vendor.

The specific objectives of this audit, then, were to:

1. Determine if the state should continue to warehouse and deliver office supplies or if these functions can be outsourced more cost effectively; and

2. Briefly evaluate office supply procurement practices in political subdivisions including higher and public education to determine whether they may benefit from using the state contract.

Chapter II
Stockless Contract Makes Central Stores Obsolete

Because of current capabilities in the private sector and a new office supplies contract being negotiated by the Division of Purchasing and General Services (Purchasing), the Central Stores operation has become functionally obsolete. A "stockless" contract is being developed which will allow state agencies to order and receive merchandise directly from the office supply vendor under contract. Thus, the state will no longer need to warehouse and deliver products, and eliminating Central Stores will save the state approximately $500,000. We believe this new stockless contract is a positive move because office supplies will cost less to state agencies, and the system will provide a more direct and efficient method of product ordering and delivery. In addition, nearly every other state we contacted uses a stockless system of office supply procurement. As of the writing of this report, Purchasing is working towards full implementation of this contract and plans to close operations at Central Stores by October 1997. We believe they should continue the process so that the Central Stores operation can be phased out as quickly as possible.

This chapter discusses why Central Stores is obsolete and why a vendor-direct system is superior, reviews office supply purchasing in other states, and illustrates the estimated savings from eliminating Central Stores.

State Handling of Office Supplies is no Longer Cost Effective

Because of the provisions of the new office supplies contract, Stores is no longer needed for the essential reasons it was created: bulk purchasing, warehousing, and delivery of products. The old system of office supply procurement is not as effective as the proposed model because products had to be handled more frequently and by more people, and because delivery time under the old system typically did not meet the industry standard of next-day.

Product Handling has Been Excessive

Products must be handled more frequently with a state-operated central warehouse than with a vendor-direct system because they are shipped from the vendor to the central warehouse and then to the customer.

Historically, when agencies ordered items from Stores, they did so through either an on-line ordering system, fax, or phone. At Stores, orders were then printed out and reviewed by office personnel for what items were requested. Orders for stock items were placed in a basket where they were retrieved by Stores warehouse personnel, filled, and then packaged for delivery.

Packages were picked up daily by a contracted courier service and delivered to state agencies. In addition to warehoused items, state agencies ordered other products from Stores. If "special order" items were requested that were not warehoused by Stores, they had to be specifically requested by Stores from the appropriate vendor. These orders were received and filled by the vendor and then delivered to Stores where they had to be received, unboxed, and checked for accuracy by warehouse personnel. They were then repackaged at Stores and delivered by the courier service under contract. As this description indicates, the involvement of a state "middleman" created a time-intensive process and an excessive amount of product handling.

Delivery Time has Been a Problem

Because of excessive product handling, the time required for Stores to fill and deliver orders has historically been slower than the industry standard of next-day delivery. We reviewed a sample of 52 orders placed by state agencies along the Wasatch Front to Stores during April-June 1997; on average, we found it took 2.6 days to fill and deliver orders for warehoused items. Figure III summarizes our findings.

Figure III
Percent of Deliveries Filled Within Specific Time-Frame for Warehoused Items

Time to Fill and Deliver Order	Number of Orders Filled	Percent of Orders Filled	Cumulative Percent
1 Day	20	38.5%	38.5%
2 Days	19	36.5	75.0
3 or More Days	13	25.0	100.0
TOTAL	**52**	**100.0%**	**100.0%**

Traditionally, Stores has tried to fill and deliver orders received no later than 1:00 PM by the next working day to agencies, but Figure III shows next-day delivery occurred less than 40 percent of the time. Under the new contract (which is discussed in more detail later), all orders from agencies along the Wasatch Front are supposed to be filled and delivered by the next working day.

In addition to our analysis, a recent study by Brigham Young University graduate students reviewed agency satisfaction levels with several aspects of Stores, one of which was delivery time. The aggregated result showed that only 28 percent of Stores' customers said they received their orders within 1-2 days, while the majority, 52 percent, said they received orders within 3-5 days.

We also contacted personnel in state agencies who have purchased office supplies from vendors other than Stores to understand why they don't always use Stores. They specifically mentioned slow delivery as one of the reasons they sometimes use other vendors to purchase office supplies. They said that Stores often takes 2-3 days while other vendors routinely provide next-day delivery of products. Other concerns specifically mentioned were that 1) items are more expensive through Stores; 2) Stores has limited product selection; 3) Stores sometimes delivers incorrect items; and 4) other vendors provide better customer service. We feel a vendor-direct system should reduce or eliminate these concerns altogether.

Vendor-Direct System Better Meets Customer Needs

Due to competition and the strength of the industry, we believe the private sector is better equipped to handle state agency office supply needs than a state Central Stores function. Although historically there has been a place for the Central Stores operation, that role has become obsolete. In addition, the vendor awarded the state contract will be able to satisfy almost all state agency office supply needs, including those which have previously been filled through other contracts. Based on our estimates, we believe the state will save as much as $500,000 by eliminating Central Stores.

Service and Pricing are Improved

The problems previously mentioned with Stores regarding delivery time, product availability, pricing, and customer service should be largely eliminated with a vendor-direct system for the following reasons:

1) **Maturity of the Industry -** The office supply industry has matured in Utah, and three large, nationally or regionally-based vendors submitted bids for the State's office supply contract earlier this year. However, multiple vendors have not always been the case. In 1992, Stores analyzed the possibility of going to a stockless operation. Though the features were attractive, the conclusion was that the risk of closing the central warehouse and delivery system in place would be too great because only one vendor at the time could perform a direct delivery business.

2) **Buying Power of Large Vendors -** These vendors fill office supply needs for many different organizations, and their large volume purchasing from manufacturers enables them to receive favorable pricing. For instance, the vendor awarded the office supplies contract reports annual worldwide sales of $6 billion in office supplies and office furniture. The new contract offers deep discounts on close to 600 core items used most frequently by the state, as well as a 53 percent discount off the list price for most other items contained in the vendor's catalog.

3) **Support Infrastructure in Place -** The vendor awarded the contract has a 76,000 square

foot warehouse in the Salt Lake valley where over 11,000 items are stocked (as compared to a 9,000 square foot warehouse storing 600 items at Stores). In addition, delivery systems are already in place to provide desktop service to ordering agencies, and the vendor reports a next-day delivery rate on 99.5 percent of local orders. Under the newly negotiated stockless contract, delivery of products will be direct from vendor to the ordering agency, item prices should include all costs of delivery, and delivery is supposed to be on a next-day basis to any location between Logan, Springville, Park City, and Tooele. Deliveries outside the Wasatch Front will be handled by courier service under contract with the vendor and are generally supposed to take about 2-3 days.

4) **Elimination of a Middleman -** With office supplies delivered directly to ordering agencies, products are warehoused only once (rather than twice with Stores) and are handled by fewer people meaning costs are less and delivery time is not delayed. In addition, the number of items which will have to be special ordered will be less than with Stores because a far greater number of orders can be filled directly from a large vendor's warehouse.

5) **Enhanced Customer Service -** Customers have direct interface with the vendor so all ordering, billing, or product inquiries or concerns can be answered directly by customer service staff. Implicit in this supplier-client relationship is that the vendor will do all it can to make sure customers are satisfied and continue to use the contract since it is the vendor's livelihood. The vendor awarded the bid made it clear that the state's business is key to its success. Having a direct interface with customers gives the vendor an opportunity as well as an incentive to earn the satisfaction of state agencies and capture more of the state's business through competitive pricing and quality customer service.

These are some of the reasons we feel a vendor-direct system makes more sense and will save money for state agencies. It should be understood that the pricing under the new contract is supposed to be guaranteed for the period of the contract unless the vendor receives a price increase or decrease directly from a product manufacturer. In the instance of a manufacturer price increase, the vendor may increase their prices to the state by a similar amount, but only if supporting documentation from the manufacturer is provided. According to Purchasing staff, the vendor may not increase prices to the state to cover any increases in internal operating costs. The contract also stipulates that any decrease in product prices from a manufacturer to the vendor are to be passed along immediately to the state.

With respect to delivery, agencies along the Wasatch Front are supposed to receive their orders by the next working day. This was specifically requested in the bid document and specifically assured by the vendor in their bid response. Although remedies to the issue of "nonperformance of contractual requirements" are addressed in the contract, no specific standards of what constitute acceptable performance have been predetermined, and there is nothing in the contract that automatically imposes any kind of consequence if the vendor does not achieve next-day delivery. Although the vendor reports a 99.5 percent next-day delivery rate locally and seems to have the infrastructure to meet this standard, the state needs to make sure it protects itself and takes appropriate actions if the next-day delivery rate drops below a certain threshold. We are not suggesting this will happen, but if, for instance, the vendor chooses to grow in the local market faster than they can actually support, next-day delivery rates may suffer. We believe that pricing and delivery are areas where contract oversight could be very valuable, and this is precisely how Purchasing plans to utilize a contract administrator. As a proactive measure, however, we encourage Purchasing to begin developing specific standards of performance for the vendor. We also encourage Purchasing to develop consequences or incentives for the vendor to consistently maintain performance levels and correct problems that might occur.

Contract Vendor can Handle Supply Needs

The vendor awarded the state contract will be able to satisfy most state office supply needs including much of what has previously been purchased through other contracts. As mentioned earlier, Stores has historically ordered supplies from several vendors under contract. With most office supplies soon to be obtained through one vendor on a stockless basis, Purchasing has had to determine how products through the other contracts could be obtained most cost effectively. In fact, many of these items will now be procured through the main office supply vendor on a stockless basis at essentially the same cost as before.

Figure IV shows the dollar volume of products Stores purchased from different vendors for resale to state agencies.

Figure IV
Central Stores' Payments to Vendors for Fiscal Year 1997

Product Category	Vendors	FY 1997 Payments	Percent of Total Payments
Office Supplies	Office Depot Business Services	$2,108,101	66.7%
Small Quantity & Specialty Paper	Dixon Paper, Williamette, Xerox	433,782	13.7
Franklin Planners	Franklin Quest Stores	152,151	4.8
Miscellaneous Supplies	Various vendors	135,916	4.3
Large Quantity Paper	Unisource Corporation	129,007	4.1
Forms and Publications	Publishing Services, American Business Forms, American Graphics	80,295	2.5
Specialty Envelopes	Intermountain Envelope Company, LeFavor Envelope Company	78,387	2.5
Industrial Paper	Sysco Intermountain Food Services	21,397	.7
Janitorial Supplies	Hylon Koburn Chemicals Inc.	10,676	.3
Paper Cups	Theatre Candy Distributing Co.	9,167	.3
TOTAL		**$3,158,879**	**100.0%**

As shown, about two-thirds of all items sold by Stores were provided through the office supplies contract last year, while the remaining third was supplied through several other vendors under contract. As mentioned, the office supplies vendor will be able to satisfy many product needs that have traditionally been met through these additional contracts, and Purchasing has developed a method so that all products can be purchased on a stockless basis.

Depending on the quantity of product being ordered, agencies will be instructed to order from either the new office supplies contract or the vendor under contract so that the best price can be obtained. For instance, envelopes, janitorial supplies, industrial paper, and paper cups will be provided through the specific vendor under contract if the order achieves the minimum required by the contract to receive free delivery. Otherwise, orders will be filled directly through the main office supplies contract and delivered like any other item. Generally, these smaller orders placed through the office supplies contract may cost agencies a little more, but the difference is minimal considering that these four product categories account for less than 4 percent of Stores sales.

According to Stores management, forms specific to the Department of Transportation (which is the majority of items in the forms category) will be stored directly at its own warehouse. Generic state forms will be supplied by Publishing Services and printed on an as needed basis, and ultimately state agencies will be able to print many of the forms needed directly from computer through special software. Agencies can purchase Franklin products from either the office supplies vendor at the current state discount or order them directly from the company.

Paper is the biggest single item not historically procured through the main office supply vendor. Purchasing has arranged a solution so that larger quantities (orders of approximately 20 or more cases) can be purchased and shipped directly from the vendor under contract without the ordering agency incurring a delivery charge. Orders for less than the minimum required to avoid delivery charges will be filled directly from the office supplies vendor and delivered like other items. Though paper prices are quite volatile, initial comparisons indicate that the cost of ordering smaller quantities of paper through the office supplies vendor are very competitive with prices under the paper vendor contract and will be less than what agencies used to pay from Stores. Prices for larger quantities, shipped directly from the paper supply vendor, will clearly be less than what it has previously cost because the ordering agency will not be paying the 18 percent Stores markup. We believe this plan is sensible and cost effective; otherwise, a small Stores warehouse and delivery system would have to be maintained to fill orders for these items.

Elimination of Central Stores Will Create a Savings

Because of the reasons mentioned previously regarding economies of scale and existing infrastructure, the cost for the state to purchase products will be less in the future than if a Stores operation were continued. We do not know for sure what product costs would have been had a Stores operation been continued because the last bid only requested prices for a vendor-direct delivery system. However, even if it costs less for a vendor to deliver products to one central location, the overall expense of retaining a Stores operation would be greater because warehouse, delivery, and personnel costs would still be incurred.

We asked the office supplies vendor how product prices would be affected if delivery was only to a central location. The vendor acknowledges costs would be less to deliver only to a Central Stores, but the vendor also claims their costs are not significantly greater to deliver to individual agencies because delivery routes and vehicles are already in place and in use. In addition, the vendor believes increased customer satisfaction and purchasing volume from state agencies and political subdivisions will compensate for whatever additional costs are incurred from an agency-direct delivery system.

Consequently, the vendor told us that products costs would have been essentially the same for either a stockless delivery system or a central warehouse system.

The following figure estimates the difference in various cost categories between the new stockless system and if a Stores operation had been continued.

Figure V
Savings of Changing to a Stockless Office Supply System

Expense Category	Approximate Savings/(Loss)
Cost of Products	$ (80,000)
Personnel	260,000
Freight (Delivery)	220,000
Warehouse	60,000
Other Expenses	50,000
TOTAL	**$ 510,000**

What this figure conveys is that the cost of products will be more under the new stockless system (roughly $80,000), but overall the state will realize a savings of about $500,000 due to the elimination of direct personnel, warehouse, and delivery expenses incurred by Stores. The $80,000 cost of goods is based on estimates of product costs under a continued Stores operation versus cost estimates under the stockless system for all products including paper and other items traditionally obtained through other contracts. Part of the reason product prices would be less if a Stores operation were continued is because the vendor would only have to invoice and bill Stores rather than hundreds of different agencies. However, because the new contract does require agency-direct delivery, product prices include a markup of approximately 4 percent for the separate invoicing and billing that must be done. This markup accounts for approximately $70,000 of the $80,000 figure. The other $10,000 is the approximate increase in product prices for agencies to obtain items such as paper and cleaning supplies through the office supplies vendor.

As mentioned, however, these additional product costs are fairly minor compared to the savings the state will realize by eliminating direct Stores expenses. The figures used for warehouse, delivery and personnel expenses are based on actual Stores costs for FY 1997. Personnel expenses were actually about $320,000, but it will cost Purchasing about $60,000 to retain a contract administrator for the new system so the savings of eliminating personnel is roughly $260,000.

Other States Use a Vendor-Direct System

Most states we contacted have adopted a stockless system of office supply procurement. Several states have been using this system for a number of years and indicated that they are very satisfied with the vendor-direct arrangement. We believe the experience and satisfaction of other states is further reason for the elimination of Stores. However, few of the states using a stockless system have a separate person designated to administer the office supplies contract like Purchasing is proposing. We believe there is a need for contract oversight, especially during the transition to a stockless system, but we think the need for a full time position on a long term basis should be reviewed by Purchasing.

Many Western States Use a Stockless Contract

We contacted several states surrounding Utah to evaluate the use of stockless office supplies contracts. Of the nine we contacted—Arizona, California, Colorado, Idaho, Montana, Nevada, Oregon, Washington, and Wyoming—all but two have stockless office supply contracts where all transactions and interface are handled between the vendor and ordering agencies. Montana and Washington still maintain a state central warehouse and have never used a stockless system. Figure VI below summarizes these findings.

Figure VI
Office Supply Procurement in Other States

State	Central Stores Operation or Stockless	Method of Ordering & Billing for Office Supplies	Method of Answering Service Questions	Is There a "Contract Administrator" & Rebate*
Arizona	Stockless	Vendor-direct	Vendor	No/No
California	Stockless	Vendor-direct	Vendor	Yes/Yes (1%)
Colorado	Stockless	Vendor-direct	Vendor	No/No
Idaho	Stockless	Vendor-direct	Vendor	No/Yes (.5%)
Montana	CS	CS	CS	n/a
Nevada	Stockless**	Vendor-direct	Vendor	No/Yes (5%)
Oregon	Stockless	Vendor-direct	Vendor	Yes/Yes (1%)
Washington	CS	CS	CS	n/a
Wyoming	Stockless	Vendor-direct‡	Vendor/state‡	No/No
Utah †	Phasing out CS	Vendor-direct	Vendor	Yes/Yes (2%)

** The "No" states have a purchasing agent over the contract but do not have a separate "contract administrator" position. Of the states that have vendor rebates, the percentages listed pertain to a rebate on annual office product sales in the state.*

*** Nevada maintains a warehouse mainly for photocopy and laser print paper purchased on state contract.*

‡ Most ordering is done at the agency level in Wyoming with an occasional purchase order being used. Also, there are a few agencies that prefer to work through the state purchasing office for service-related problems or inquiries.

† Proposed (Purchasing's goal is to implement the stockless system by October 1997).

As the above figure shows, most every state surrounding Utah has made the move to a stockless office supplies contract with agency-direct ordering and billing. Many of these states—Arizona, Colorado, Idaho, and Oregon—have been using a stockless system for several years and have gone through multiple contract bid solicitations. They all said they have continued to obtain very competitive pricing through the bid process and feel the stockless system has worked very well for them. We believe this success further supports the move to a stockless system and away from state warehousing and delivery.

Contract Administration Needs Should be Reviewed

As previously mentioned in this report, Purchasing is planning to keep one person as a contract administrator to oversee the new office supplies contract. In addition, they plan to pay a manager to oversee the contract administrator in addition to overseeing managers for two other new programs unrelated to the office supplies contract. The contract administrator will perform several functions such as notifying all state agencies—including those who purchase office supplies from other sources—of the contract's benefits, verifying price increases submitted by the vendor and product prices actually charged agencies by the vendor, and monitoring service levels such as delivery times. Purchasing plans to fund this position, and a portion of the manager's position, with a 2 percent markup on all products ordered through the office supplies contract—completely separate from what the vendor is charging—which will then be rebated back to Purchasing from the vendor on a monthly basis.

We see a need for oversight of the new state contract, especially during the period of transition to the stockless system. However, we do not know how much time will be necessary to perform these functions, especially as the stockless system becomes more fully integrated, and we are not sure these functions will always require a full-time position. As previously noted, Figure VI shows that seven of the states we contacted have a stockless operation. Of these, all have a purchasing agent who actually negotiates and develops the conditions of the contract, as does Utah. However, only two states, California and Oregon, have in addition a contract administrator to monitor and oversee the provisions of the contract. We do not know the full scope of what the people in these positions do, but we are not sure that Utah needs one full-time contract administrator on a long term basis when a state the size of California has only one such person. We do not discount the need for contract oversight and marketing of the contract's benefits to state agencies and political subdivisions, but we believe Purchasing should review these needs over time to see if they might require less than a full-time position.

New Contract Will Save Money for State Agencies

Office supplies will cost less for state agencies under the newly negotiated contract than what they have traditionally paid through Stores. This is due to the elimination of the direct warehouse, delivery, and personnel expenses of Stores and the fact that competition has lowered product prices. Also, agencies choosing to use other office supply vendors will likely pay more for products than if they were to use the new state contract.

Contract Will Reduce Supply Costs

Our calculations show that state agencies will spend roughly 25 percent less for basic office supply items under the new contract than what they used to pay. Figure VII compares product prices for a random selection of frequently used items. As can be seen, all items in this figure will be less expensive under the new contract.

Figure VII
Central Stores Vs. New Contract Price Comparison for Core Items

Item Description	FY 1997 Volume	FY 1997 Agency Cost Under Central Stores*	Agency Cost Under New Contract	Percent Difference
Maxell VCR tape (120 min)	2,429 ea	$2.59	$1.77	31.6%
Paper Mate pen (ultra fine)	189 ea	.36	.19	47.6
Paper Mate marking pen (extra-fine)	366 ea	.36	.19	47.6
Sanford roller pen (fine)	3,181 ea	.75	.60	19.9
Sanford "Sharpie" marker (fine)	7,271 ea	.68	.36	46.7
Office Depot hole punch (2 hole)	607 ea	3.89	2.25	42.2
Acco binder clip (large; #100)	1,187 dz	1.89	1.07	43.0
Cosco dater line stamp (8-year; #1.5)	141 ea	2.05	.89	56.6
Wilson Jones ring binder (ltr., 1")	1,872 ea	2.54	1.40	44.8
Wilson Jones insertable indexes	10,391 sets	.40	.29	29.0
Smead file folder (a cut, 100/box)	92 bx	8.09	4.16	48.6
Smead file guide (1/5 cut; A-Z)	31 sets	8.00	5.14	35.7
Globe-Weiss desk file (ltr., A-Z)	185 ea	5.13	3.39	33.8
Office Depot hanging folder (a cut)	795 pk	1.17	.53	54.7
Keith Clark weekly book (3¾" x 6")	77 ea	3.85	3.22	16.3

* ***These prices include the appropriate markup to cover Central Stores's warehouse and delivery costs.***

Non-Contract Purchasing Will Cost More

Based on our analysis, agencies who do not use the state contract may pay more than is necessary for office supplies. Even though most agencies are by law required to use the services of Stores, some agencies have used other office supply vendors for various reasons as previously mentioned. We reviewed a sample of 1997 purchases made by state agencies to various local office supply vendors, none of which are under state contract. We compared the prices actually paid for these items with the prices for the same items under the new state contract. Our analysis shows that prices for the items we could compare were about 36 percent more than prices for the same items under state contract. Considering that in fiscal year 1997 the approximated volume of office supplies purchased from non-contract vendors was about $800,000, we estimate a potential savings of between $100,000-$200,000 depending upon the extent to which the office supplies vendor can provide the same items.

In 98 percent of the item purchases we sampled (119 of 122), the agencies paid more for the particular item than what the item will cost under the new state contract. The following figure illustrates some of these comparisons.

Figure VIII
Purchases From Other Office Supply Vendors

Date of Purchase	Item Purchased	Actual Price Paid per Unit	Price Under New State Contract	Percent Difference
3/25/97	*Rubbermaid* File Hanger	$47.50	$29.61	60.4%
2/28/97	*Sony* 8mm Data Cartridge	6.95	7.03	-1.1
2/03/97	*Softalk* Phone Rest	6.92	3.22	114.7
3/31/97	*Rolodex* Card File	22.80	10.43	118.6
3/27/97	*Bostitch* Stapler	11.45	8.90	28.6
4/09/97	*Wilson Jones* Binders	2.00	1.53	30.5
4/09/97	*Fellowes* Wire Trays	4.85	2.15	125.7
3/26/97	*BIC* Whiteout	1.15	.84	36.7
3/27/97	*Sanford* Roller Ball Pens	1.08	.79	36.0
3/27/97	*3M* Post-it ™ Notes	4.71	2.97	58.8
4/01/97	*CLI* Sheet Protectors	5.20	3.14	65.7
3/28/97	*Apollo* Projector Bulb	28.75	19.71	45.9
3/31/97	*Rogers* Card File	2.15	.75	185.9
4/17/97	*Pilot* Highlighters	1.47	.84	74.7

As a point of clarification, we are not saying that these agencies could have saved as much as is demonstrated above. At the time these purchases were made, the new contract had not even been negotiated and these prices were not even available. Based on this sample, however, we are saying that if these patterns of purchasing from other vendors continues in the future, agencies will very likely be paying more for office supplies than if they use the new state contract. We believe that all agencies need to understand that pricing and services under the new contract are much more attractive than what has previously been offered through Stores.

In the next chapter, we discuss the benefits the new contract may have for political subdivision of the state including both public and higher education.

Chapter III
Political Subdivisions may Benefit From the New State Contract

In addition to saving money and improving service for state agencies, using the state's stockless office supply contract may provide similar benefits to the state's political subdivisions including higher education institutions, public school districts, and local governments. Although it was not specifically part of the audit request, we briefly reviewed the office supply purchasing practices of political subdivisions. Our analysis indicates that some higher education institutions can immediately benefit from the pricing under the new contract. We also believe that school districts may benefit from using the stockless contract and should evaluate their current costs of office supply procurement and compare these with the new contract prices. In addition, our discussions with one city suggest that local governments can also benefit from using the new state contract. We recommend that Purchasing inform political subdivisions of the prices and services available to them from the state contract and encourage each one to evaluate whether it would benefit from using the contract.

Because of the varied needs of political subdivisions, each entity needs to review whether it should use the state contract. Those entities that already have stockless systems may only need to compare prices and services available. Other subdivisions that now buy commodities in bulk and have their own distribution systems may require a more complicated analysis of their marginal costs. One factor that each subdivision needs to consider is a provision in the state contract prohibiting selective use of the state's vendor based on item prices. Thus, political subdivisions need to evaluate possible use of the state's vendor on an all or nothing basis, at least for the contract's core items. Whether or not political subdivisions use the state contract, the stockless office supply industry is now well enough developed in Utah that each subdivision should evaluate the benefits of using the stockless contract as compared to current methods of office supply procurement.

Higher Education Institutions can Save Using State Contract

Institutions of higher education can save money by checking prices under the new state contract before purchasing office supplies from other vendors. We reviewed practices for purchasing office supplies at the University of Utah (U of U) and the College of Eastern Utah (CEU). We contacted other institutions as well, but we did not review their office supply purchasing practices because many are already using or are planning on using the new state contract. In addition, we began to sample office supply purchases made by Snow College, but ultimately we could not report the price comparisons because we were unable to obtain their total costs of procuring office supplies.

We looked at a small sample of items purchased by individual departments from both the campus bookstore and from local office supply vendors at the U of U and CEU. We found that in both cases the cost for departments to purchase these products from these sources was more than prices under the state contract. As in the previous chapter, we are not saying these institutions have made poor purchasing decisions. Prices under the new contract have just recently become available and were not even an option when the departments may have made their purchases. However, we are saying that if these kinds of purchases continue in the future, institutions will likely be paying more for office supplies than if they use the new state contract. We believe it is in the best interest of these departments to compare prices under state contract before purchasing from other sources.

For example, a small sample of items at the U of U shows that it costs departments roughly 40 percent more on average to buy through the bookstore than if they were to use the new state contract. At CEU, this same figure is about 45 percent. The figure below shows some of these price comparisons.

Figure IX
Campus Bookstore Vs. State Contract
Comparison of Office Supply Prices

Institution	Item	Department Price from Bookstore	State Contract Price*	Per cent Difference
U of U	*Pentel* Pencil Refill	$.80	$ .47	70.2%
U of U	*BIC* Round Stic Pen	.15	.14	5.7
U of U	*Scotch* Magic Tape	2.24	1.52	47.1
U of U	*3M* Transparencies	41.39	28.81	43.7
CEU	*Smead* File Folder	9.88	6.49	52.3
CEU	*3M* Post-it ™ Notes	4.68	3.50	33.7
CEU	*Elmers* Glue	1.52	1.26	20.2
CEU	*Sparco* Staples	1.17	1.08	8.2

***   Price includes the 2 percent charge to cover the cost of contract administration.***

In addition, prices paid for office supplies from vendors off campus are more than what the same items cost under state contract. Our sample shows that prices at the U of U are about 40 percent more on average than state contract prices when buying through other vendors, and at

CEU the figure is roughly 50 percent. Figure X shows some of these potential savings.

Figure X
Local Vendors Vs. State Contract
Comparison of Office Supply Prices

Institution	Item	Vendor Price	State Contract Price*	Percent Difference
U of U	*Avery* Labels	$5.71	$3.82	49.6%
U of U	*Pilot* Rolling Ball Pen	1.30	.98	32.3
U of U	*Esselte* File Folders	15.10	8.74	72.8
U of U	*Custom X* Stamper	24.95	13.75	81.5
U of U	*Acme* 8" Scissors	10.99	8.51	29.2
CEU	*Maco* Labels	3.06	2.04	50.4
CEU	*3M* Magic Tape	1.89	1.52	24.1
CEU	*Elmers* Glue	1.39	1.26	9.9
CEU	*Rodgers* Desk Tray	2.87	1.23	133.1

** Price includes the 2 percent charge to cover the cost of contract administration.*

We realize that it will likely take longer for institutions in rural areas of the state to receive products through the state contract than through the bookstore or a local vendor, but the price differences shown in our sample indicate that the state contract can save money for higher education institutions. We were unable to obtain a large sample of items from these institutions in doing our analysis, and we do not know how different the results might look for a broad comparison of prices. However, we believe these examples show that money can be saved by using the state contract. With better planning and coordination of supply needs, it seems reasonable that departments at higher educations institutions could purchase office supplies at a savings through the state contract without negatively affecting their on-hand supplies.

School Districts Should Evaluate Cost-Benefit of Using a Stockless System

Unlike higher education institutions, a number of factors complicate the decision of whether public school districts should use the state office supplies contract. For example, many large districts may already maintain a warehouse and may not realize any savings because they will continue to warehouse and deliver a variety of school products regardless of whether they use a stockless office supply system. In addition, small districts may not realize any savings because they may already be purchasing supplies from a subsidized warehouse operated by the Davis County School District. We reviewed office supply procurement practices at Jordan and Murray School Districts, but it was beyond the scope of our audit to evaluate all the potential costs and benefits to the districts of using the state office supply contract. We believe districts should evaluate their practices to see if they may benefit from prices and service available under the new state contract.

Jordan, one of the state's largest school districts, would continue to operate a warehouse even if it used the state office supply contract. Jordan has a 32,000 square foot warehouse to store many items besides office supplies such as food, carpet, plumbing supplies, athletic supplies, and other educational supplies for district use. The warehoused items, including office supplies, are procured through a bid system and delivered to schools by district personnel. Our analysis of prices paid for a sample of office supply items shows that Jordan is paying less through their bidding system than what they would pay for these items under the new state contract; however, our analysis does not include the cost for Jordan to warehouse and deliver these products. Since Jordan warehouses and delivers a variety of products to schools, the additional cost of doing so for office supplies may not be significant. It was beyond the scope of our audit to determine the marginal costs incurred by the district to warehouse and deliver office supplies.

It may be worthwhile, however, for Jordan and other districts to do their own analysis of these costs and compare them with prices under state contract. Even if it is not currently more cost effective for schools with warehouses to order office supplies directly from state contract, it may become so in the future. Using a stockless office supply system could eliminate the need to complete planned warehouse expansion and free up warehouse and delivery personnel for other district uses.

We also looked at office supply purchasing at Murray School District, which is much smaller than Jordan and does not have its own warehouse. Murray purchases office supplies from Davis County School District which has a large, subsidized warehouse allowing it to sell office supplies to other school districts at low prices. Murray employs one person to pick up the supplies at the Davis warehouse and deliver them to ordering schools. Our analysis of a sample of items shows that Murray bought most items cheaper through Davis district than what it would cost under the state contract. Of 370 "line-item" requisitions from various Murray schools to their district office during a 6-week period of March and April 1997, we were able to compare the prices of 37 items. Using the actual quantities purchased of the 37 items we compared, Murray School District paid $640 for the items compared to an estimated cost of $730 for the same items under the new state-wide contract, a difference of about 14 percent. However, to obtain these lower prices, the district incurs personnel and vehicle costs associated with the pick up and delivery of these supplies. When the delivery costs are factored in, it may make prices under the state contract favorable.

We believe that school districts, particularly smaller ones such as Murray, could benefit from an expanded internal study of all costs associated with office supply procurement and delivery. Although the delivery person for Murray performs other duties such as food pick-up and delivery and equipment repair, a more complete study of costs might show a savings by using the office supplies contract and freeing up more of his time for these other duties. Even if current district prices are more favorable, moving away from independent pick up and delivery of office supplies may make more sense in the future as pricing and service under vendor-direct systems become more competitive. One unresolved issue is whether all Murray's supply needs can even be satisfied through the state's new stockless contract. If certain supplies must still be obtained from Davis, then Murray may not realize any pick-up and delivery savings from using the stockless contract. However, in contacting other school districts to see how they procure office supplies, Juab, Washington, and Park City districts all indicated that they are planning on using the state's stockless office supplies contract in either whole or part.

Local Governments can Also Benefit From the Stockless Contract

Other political subdivisions such as cities, counties, and special districts also may benefit from using the state's office supplies contract. Compared to school districts, local government office product needs are more easily satisfied by a stockless supply system. In fact, according to our telephone discussions, some local governments already have stockless office supplies contracts. For example, the purchasing department for Salt Lake City reports it has used a stockless supply system for six years, although it does not use the state's vendor. Other entities, such as West Valley City, now have stockless contracts with the state's vendor. Each local government should evaluate whether using the state's contract can be beneficial. We believe the low prices and next-day delivery service available from the state's stockless office supply vendor can benefit many local governments.

West Valley City (WVC) provides an example of potential savings from using the state contract. WVC received a 42 percent discount off catalog items and even more on about 100 most frequently used "core" items under their most recent contract. As a political subdivision of the state, WVC can now "piggy back" on the new state contract and receive 53 percent off catalog items and even more on close to 600 core items. Since the same vendor has both contracts, service should remain the same although prices are considerably lower under the state contract. By buying at the state contract prices, WVC will realize a savings of almost 20 percent over their previous contract prices. Considering West Valley purchased about $74,000 worth of office supplies in FY 97, the potential is for a savings of about $14,000 per year. According to the WVC individual we spoke with, the vendor's computer will automatically determine the lowest contract price available and award that to WVC.

We believe each local government should evaluate whether it can save money or improve service by using the state's contract. Purchasing should inform each political subdivision of the terms of the state's office supply contract and encourage each entity to evaluate whether it can benefit from using the state contract.

Recommendations:

1. We recommend that the Division of Purchasing and General Services (Purchasing) continue their plans to eliminate the Central Stores operation as soon as possible.

2. We recommend that Purchasing notify state agencies of the benefits of the new state contract and make them aware that all purchases can be made directly from the vendor. In addition, we recommend that Purchasing inform state agencies that the historical concerns about Central Stores (such as product selection, pricing, and delivery time) should be eliminated by using a vendor-direct system.

3. We recommend that Purchasing review office supply purchases made by agencies from other vendors, compare the prices paid with the state contract prices, and educate agencies as to differences in cost.

4. We recommend that Purchasing notify all political subdivisions of the benefits of the new state contract and make them aware of the prices and services available. We also recommend that Purchasing encourage school districts, particularly smaller districts, to evaluate all costs associated with office supply procurement (including warehousing and delivery) and compare these costs with prices under the new state contract.

5. We recommend that Purchasing develop specific performance standards with the office supplies vendor. We further recommend that Purchasing monitor vendor performance for compliance with these standards, and develop appropriate incentives or penalties to encourage the vendor to achieve these performance standards.

6. We recommend that Purchasing evaluate whether the functions referred to in these recommendations can be done with existing departmental staff, including internal audit staff, or if a separate position, such as a contract administrator, is necessary.

Agency Response