



City of New York

OFFICE OF THE COMPTROLLER

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COMPTROLLER



MANAGEMENT AUDIT

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Deputy Comptroller for Audit

Audit Report on the Department of
Education's Custodial Supplies
Management Contract with
Strategic Distribution, Inc.

MG13-079A

June 25, 2014

<http://comptroller.nyc.gov>



THE CITY OF NEW YORK
OFFICE OF THE COMPTROLLER
SCOTT M. STRINGER

June 25, 2014

To the Residents of the City of New York:

My office has audited the adequacy of the New York City Department of Education's ("DOE's") controls over the awarding and monitoring of its custodial supply management contract with Strategic Distribution, Inc. ("SDI") and whether the contract award and monitoring followed DOE's Procurement Policy and Procedures ("PPP") guidelines. We audit City operations such as this as a means of increasing accountability and ensuring that City resources are used effectively, efficiently, and in the best interest of the public.

The audit found that DOE did not have adequate controls over its award of the custodial supply management contract to SDI. The evidence provided by DOE was insufficient to establish that it conducted a fully competitive contract award process or performed an adequate price analysis before it awarded the contract to SDI. DOE also failed to adequately monitor its contract with SDI in accordance with its PPP Guidelines and the terms of the contract. As a result, the City may be paying more than necessary for the purchase of custodial supplies.

The audit makes seven recommendations to DOE, including that it should (1) retain all pertinent documents related to the bidding process in accordance with its rules and policies, (2) adequately monitor its contract with SDI in accordance with the terms of its contract, and (3) track and compare market prices to the current contract prices and, when applicable, request a reduction in prices.

The results of the audit have been discussed with DOE officials and their comments have been considered in preparing this report. Their complete written response is attached to this report.

If you have any questions concerning this report, please e-mail my audit bureau at audit@comptroller.nyc.gov.

Sincerely,

Scott M. Stringer



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THE CITY OF NEW YORK OFFICE OF THE COMPTROLLER MANAGEMENT AUDIT

Audit Report on the Department of Education's Custodial Supply Management Contract with Strategic Distribution, Inc.

MG13-079A

AUDIT REPORT IN BRIEF

This audit determined: (1) the adequacy of the New York City Department of Education's ("DOE's") controls over the award and monitoring of its custodial supply management contract with Strategic Distribution, Inc. ("SDI"); and (2) whether in awarding and monitoring the contract, DOE followed its Procurement Policy and Procedures ("PPP") guidelines (the "PPP Guidelines" or the "Guidelines").

On July 1, 2010, DOE entered into a five-year contract with SDI for the purpose of furnishing and providing on-site delivery of custodial supplies to the approximately 1,200 public schools throughout New York City under the jurisdiction of DOE. The contract was valued at \$88.1 million with an option to extend another six months for an additional \$8.7 million.¹

Audit Findings and Conclusions

DOE did not have adequate controls over its award of the custodial supply management contract to SDI. The evidence provided by DOE was insufficient to establish that it: (1) conducted a fully competitive contract award process; or (2) performed an adequate price analysis before it awarded the contract to SDI. As a result, the City may be paying more than necessary for the purchase of custodial supplies.

In addition, DOE failed to adequately monitor its contract with SDI in accordance with its PPP Guidelines and the terms of the contract. As a result, DOE could not provide information about whether certain basic goals and objectives of the contract had been met, including whether goods had been purchased at reasonable prices and supplies had been promptly delivered. Additionally, there was no formal tracking system to ensure that custodian complaints pertaining to the purchase of supplies were addressed in a timely manner. DOE's failure to properly monitor the contract on an ongoing basis may have resulted in the payment of higher costs and supply shortages.

¹ DOE had previously entered into a contract with SDI for the period of July 1, 2003, through June 30, 2008, with an option to renew for two additional years. DOE exercised that option and then entered into its second contract with SDI in 2010.

Audit Recommendations

To address these weaknesses, we make the following seven recommendations:

1. DOE should retain all pertinent documents related to the bidding process in accordance with its rules and policies.
2. Where there are a limited number of bidders, DOE should conduct additional steps, such as a comparable market analysis, to ensure that the prices quoted in the bids are reasonable prior to deciding to award the contract.
3. DOE should adequately monitor its contract with SDI in accordance with the terms of its contract. Specifically, DOE should (a) review all management reports and semi-annual contract reports within the required timelines; (b) require the production of sales data from SDI; (c) conduct reconciliation of data contained within the data and the reports; and (d) discuss discrepancies and deficiencies with SDI in a timely manner.
4. DOE should track and compare market prices to the current contract prices and, when applicable, request a reduction in prices.
5. DOE should develop a mechanism for obtaining and analyzing purchasing trends and price data relative to custodial supplies.
6. DOE should develop and implement a formal complaint tracking system that would provide custodians with a vehicle for expressing their concerns and observations and that would provide DOE the ability to track complaints and determine trends and patterns that need to be addressed, such as mark-up costs inconsistent with the contract.
7. DOE should explore methods that can be used to establish better communication with its custodians about the purchase of custodial supplies, including the use of surveys, forums, and complaint forms.

Agency Response

In their response, DOE officials agreed to implement the seven recommendations cited in the report, but claimed, without providing any additional evidence, that they were already in compliance with three of the recommendations. DOE also included objections to certain findings in its response. After a careful review and consideration of the arguments in DOE's response, we found that those arguments do not alter our original findings.

INTRODUCTION

Background

DOE oversees schools that serve approximately 1.1 million students each year. Its Division of Contracts and Purchasing (“DCP”) is responsible for awarding goods and services contracts. On July 1, 2010, DOE entered into a five-year contract with SDI valued at \$88.1 million with an option to extend another six months for an additional \$8.7 million. The contract was awarded to provide on-site delivery of custodial supplies to the approximately 1,200 public schools throughout New York.

DOE’s Division of School Facilities (“DSF”) is charged with executing and monitoring the contract as part of its mandate to oversee all aspects of school building operations and maintenance. DSF provides more than 750 DOE custodians (also referred to as “custodial engineers”) with bi-monthly allocations assigned primarily for labor costs. Any excess is to be used to procure custodial supplies. The custodians are allowed to purchase supplies through two separate allocation programs – the custodial supply program and the custodial direct spend program.

Under the “Custodial Supply Program,” approximately \$10 million is designated annually for the procurement of supplies² required for the maintenance of school buildings. Custodians have the option of purchasing supplies directly from SDI’s catalogs or of requesting that SDI procure items that are not in its catalog. Because all supplies from the custodian supply program are procured through SDI, they are not subject to DOE’s bidding requirements.

Alternatively, under the direct spend program, known as the “Direct Bill” purchasing program, the custodians may use a portion of the funds allocated to their building for payment of custodial staff salaries to procure supplies from SDI or from the open market. The budgets for custodians may also be supplemented with fees from after-school activities held in their school buildings. Accordingly, the amount of funding available varies for each school, depending on the square footage of the school, the labor costs, and the various types of after-school activities. While supplies valued at \$250 or below purchased on the open market are exempt from DOE bidding requirements, purchases above \$250 are not exempt.³ In addition, cumulative purchases from a single vendor on the open market through the direct spend program cannot exceed \$2,500 per year.

The PPP Guidelines were implemented to “ensure the wise, prudent, and economical use of public money.”⁴ Specifically, they are intended “to ensure that contracts are awarded consistent with law and on the basis of best value, including, but not limited to maximum quality, lowest cost or lowest possible cost, and efficiency,” “to make as consistent as possible the uniform application of these policies throughout the DOE,” and “to provide for increased public confidence in the DOE’s public procurement procedures.”

² Supplies include items such as paper towels, toilet paper, cleaning agents, floor strippers, floor wax, etc.

³ Custodians are subject to DOE bidding requirements when making purchases from outside vendors. Telephone bids are required to be obtained for expenditures valued at \$250.01 to \$5,000; written bids are required for expenditures valued at \$5,000.01 to \$15,000.

⁴ PPP Guidelines , §1-01 (“Statement of Purpose”)

Objectives

To determine the adequacy of DOE's controls over the awarding and monitoring of its custodial supply management contract with SDI and whether the contract award and monitoring followed DOE's PPP Guidelines.

Scope and Methodology Statement

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. This audit was conducted in accordance with the audit responsibilities of the City Comptroller as set forth in Chapter 5, §93, of the New York City Charter.

The scope of this audit covers the period of July 1, 2010, through June 30, 2013. Please refer to the Detailed Scope and Methodology at the end of this report for the specific procedures and tests that were conducted.

Discussion of Audit Results with DOE

The matters covered in this report were discussed with DOE officials during and at the conclusion of this audit. A preliminary draft report was sent to DOE officials and discussed at an exit conference held on May 1, 2014. On June 3, 2014, we submitted a draft report to DOE officials with a request for comments. We received a written response from DOE officials on June 17, 2014.

In their response, DOE officials generally agreed with all seven of the audit's recommendations, but claimed that they were already in compliance with three of the recommendations: Recommendation 2 related to DOE conducting additional steps to ensure that the prices quoted in bids are reasonable in instances where there are a limited number of bidders; Recommendation 3 advising DOE to adequately monitor its contract with SDI by performing the activities set forth in its contract; and Recommendation 4 regarding tracking and comparing market prices to the current contract prices and, when applicable, requesting a reduction of prices. DOE officials also included objections to certain findings in their response. However, while these arguments were asserted in the narrative, a copy of which is attached to this audit, at no time during the audit in response to multiple requests for information or in numerous discussions related to our findings or after delivery of our draft report, did DOE provide additional evidence to support these claims. After a careful review and consideration of the arguments in DOE's response, we found that those arguments do not alter our original findings.

The full text of DOE's response is included as an addendum to this report.

FINDINGS AND RECOMMENDATIONS

DOE did not have adequate controls over its award of the custodial supply management contract to SDI. In addition, DOE failed to adequately monitor its contract with SDI in accordance with its PPP Guidelines and the terms of the contract. A competitive vendor selection process and effective contract monitoring are both necessary to ensure that goods and services are procured at fair, competitive, and reasonable prices, to reduce waste and inefficiency, and to increase public confidence in the procurement process. The weaknesses found in the procurement and monitoring of DOE's Custodial Supply Management Contract are discussed in detail in the following sections of this report.

Insufficient Evidence of a Fully Competitive Solicitation

In accordance with §3-01 of its PPP Guidelines ("Methods of Source Selection"), prior to awarding a contract to provide custodial supplies to City schools, DOE is required to use a competitive bidding process for the selection of a vendor. Afterwards, in accordance with Appendix 3 of its PPP Guidelines ("Records Retention Requirements"), DOE is required to retain a purchasing file that includes the successful and unsuccessful bids, as well as related records, for six years after the expiration or termination of the contract or six years after the final payment under that contract, whichever was later.

In connection with its procurement of the current SDI contract, DOE officials said that they requested bids from competing vendors and then selected SDI as the vendor that best demonstrated the ability to provide the supplies required at the lowest prices. However, DOE failed to maintain complete original purchasing files as required by the PPP Guidelines. As a result, DOE did not have sufficient supporting documents to demonstrate that the requisite competitive procurement process was employed and we were unable to verify that the SDI contract was procured in accordance with DOE's policies and procedures. This failure is of particular concern because during the course of the audit we were provided with inconsistent and conflicting information about the procurement of the contract with SDI.

The following deficiencies and inconsistencies were found in DOE's purchasing files and other records:

- Missing Original Bid Submission Documents – In response to the auditors' requests, DOE reported that it was not able to locate the archived boxes containing the documents for the bidding process – i.e., the original hard copy bids submitted by vendors; specific information related to each bidder, such as the principals, financial history, and solvency of the bidding companies; and the certifications and signatures of the bidders. Although DOE officials provided electronic records that they said were based on information contained in the original records, we were unable to verify the accuracy of that information because the original records were not available. In the event of a discrepancy between the hard copy and the electronic copy of the bids submitted by vendors, the hard copy would prevail. Because the contract had not expired, DOE should have retained these original bids. With the absence of these original bids, we did not have sufficient evidence to ensure that SDI was awarded the contract in accordance with DOE policies and procedures.
- Inconsistent Evidence of Bid Solicitation – DOE officials initially told us that they sent solicitation notices to 50 vendors. However, DOE had no supporting documents for its

solicitation efforts such as bid solicitation notices sent to vendors via e-mail or fax. Upon further review, we found that the DOE Contract Advice of Award indicated that six vendors had been solicited and that six vendors responded, while DOE's Contract Tracking System indicated that 72 vendors had been solicited and that five vendors responded. Finally, at the exit conference, DOE officials claimed that there were 112 downloads of the Request for Proposal ("RFP") from DOE's website. However, no documentation to support this claim was provided. Due to the inconsistent data, the significant discrepancy in the figures, and the lack of supporting documentation, we were unable to determine the number of actual vendors solicited for the bidding process.

- Inadequate Price Analysis Conducted Prior to Awarding of Contract – DOE's procurement policies and procedures requires that the award of a contract for goods and services be made to the vendor that, upon DOE's evaluation of the quality, cost, and efficiency of the bid, provides the best value to DOE. In order to be considered for a custodial supply contract ultimately awarded to SDI, competing vendors were required to submit bids for the 300 most frequently used items (referred to as Subclass A items), as well as discounts on 100 catalog items selected by DOE (referred to as Subclass B items). Only two of the six vendors that submitted bids provided unit prices for all 300 Subclass A items and only one, SDI, also provided discounts for the 100 Subclass B items. Thus, SDI was the only vendor to submit all of the required bid prices and discounts. DOE deemed the remaining five bidders to be non-responsive and awarded the contract to SDI. However, there is insufficient evidence that DOE compared SDI's bid with market prices to ensure that SDI's prices were reasonable, a procedure made all the more necessary by the fact that there were no competing prices from other responsive vendors with which to compare SDI's prices. At the exit conference for this audit, DOE officials stated that the agency did perform a market price analysis for comparison purposes using the available data it received from the other five vendors. However, the data that DOE had was incomplete, the number of vendors low, and none of the other vendors met the bidding requirements. Thus, the comparison DOE officials claimed was made was not comprehensive.
- Conflicting Information Regarding the Bidding Process – (1) For one of the bidders, DOE initially provided us with a blank bid. However, DOE subsequently provided analysis for that bid that showed tabulations of \$629,290 for 30 items of the bid. When asked to substantiate the calculations for a bid that was blank, DOE officials said that "the bid was incomplete" because the vendor did not bid on all required items. However, we never received additional evidence that this vendor bid on *any* items. (2) DOE initially stated that the "market basket" was used to determine the lowest bidder.⁵ However, upon our request for supporting documents, DOE acknowledged that it could not have used the market basket process for its calculations because SDI was the only one of the six vendors which supplied all information required for the catalog items.

The objective of a competitive bidding process is to obtain required goods and services at the lowest price from a responsive and responsible vendor. However, based on the missing documents and inconsistent information that we received, we have insufficient evidence to substantiate that DOE awarded the contract to SDI based on a competitive process consistent with DOE's rules.

⁵ Pursuant to a "market basket" analysis, DOE selects 100 items from various catalogs and divides them into 17 categories. Vendors are required to offer their best discount quotes for the 100 items, and DOE analyzes the offers, along with the bids of the 300 most frequently used items, to determine the lowest priced bidder.

DOE Response: In its response, DOE officials assert that they had, in fact, conducted a market basket analysis, claiming that “the market basket analysis, which was provided to the auditors on March 6, 2013, was conducted and was a relevant consideration in the award decision.”

Auditor Comment: For those reasons stated above (DOE’s data was incomplete, the number of vendors was low, and the bidding requirements were not met by the other vendors), we stand by our audit finding that the market basket analysis DOE officials claimed was done was not comprehensive.

Recommendations

1. DOE should retain all pertinent documents related to the bidding process in accordance with its rules and policies.

DOE Response: “The DOE agrees.”

2. Where there are a limited number of bidders, DOE should conduct additional steps, such as a comparable market analysis, to ensure that the prices quoted in the bids are reasonable prior to deciding to award the contract.

DOE Response: “The DOE agrees with this recommendation and asserts that in the case of the SDI contract procurement ‘additional steps,’ including a comparable market analysis, were taken. That is why we are satisfied that the contract awarded was based on pricing that was fair and reasonable.”

Auditor Comment: As indicated above, DOE did not provide sufficient evidence to indicate that the contract was awarded to SDI based on a substantive analysis that the pricing was fair and reasonable. Nevertheless, we are pleased that DOE agrees with this recommendation.

Inadequate Monitoring of Contract

DOE officials did not review and maintain management reports and key performance indicators essential to the meaningful oversight and monitoring of the SDI contract, nor did they require that SDI produce certain management reports mandated by the contract. Instead, DOE relied on SDI to inform it of any issues with the contract. The failure by DOE to engage in ongoing monitoring efforts mandated by the PPP Guidelines and by the contract itself leaves DOE unable to ensure that the vendor is meeting contract requirements, the custodians promptly obtain the goods or services they need at a reasonable price, and the risk of fraud, waste, and abuse is minimized.

DOE’s Failure to Maintain Records of Fiscal Reports

DOE was unable to produce accurate records concerning purchases and the corresponding payments notwithstanding DOE’s assertion that a “key element of the contract” for an “integrated supplier”⁶ of custodial supplies was the “added value” that would result from consolidated and centralized reporting on purchases made and dollars spent. According to DOE, consolidated and centralized reporting had previously been lacking for custodial supplies

⁶ An “integrated supplier” is defined as a supplier or vendor that has established relationships with various manufacturers and other suppliers. As an integrated supplier, SDI acquires supplies from those other vendors and resells the items to school custodians.

because “the in-house allocation was given directly to the custodian engineers and the DOE had no reporting of consolidated data on what was spent on a particular commodity.”

However, despite having awarded a contract to an integrated supplier, as of the date of this report, DOE had not been able to provide complete and accurate information concerning purchases made pursuant to the contract. DOE’s response to nearly all of our requests for purchase information was that it had to obtain that information from SDI. We were repeatedly told that “SDI is currently acquiring this data, and has requested that additional time be allowed as their emphasis/resources have been focused on ensuring the success of the FY 14 supply program. DSF will be following up with SDI and will pass this data along as soon as it becomes available.” In addition, we were told that DOE would need additional time for the “extensive research” required to complete our request. DOE gave various reasons for the repeated delays in providing us with the requested documents including scheduled vacations, unexpected leave usage by several staff, and preparation for the upcoming school year. In some instances, DOE did not provide us with the requested documents and gave no explanation.

The information that we requested from DOE is fundamental to its oversight of the contract and should have already been in its possession. In addition, SDI was responsible for maintaining records associated with the purchase of supplies and so should have been readily able to supply the requested information to DOE. Absent this information, DOE leaves itself vulnerable to undetected errors and fraud with its lax management of the \$88 million contract with SDI.

DOE Response: DOE asserts in response to this audit report that officials provided “detailed information to the auditors showing the exact amounts spent during the past three fiscal years.”

Auditor Comment: As described in more detail below, due to inconsistencies in the records produced, the auditors have been unable to verify the actual amounts spent on custodial supplies over the past three years.

No Review or Reconciliation of Management Reports

Pursuant to its contract, SDI is required to submit to DOE four specific management reports in both print and electronic format. DOE is required to review those reports and discuss and resolve any discrepancies with SDI. The four required reports are:

- Quarterly Spend Report – A report of the total dollar amount of purchases made by each school on a quarterly basis.
- Detailed Usage Report – An itemized list of all items purchased by schools, including the total dollar volume of purchases made and the total number of each item ordered, listed by each school both on a monthly and an aggregate basis. This report should include the catalog unit price per item as well as the applicable discount. The report should also include a list of the order numbers, corresponding invoice numbers, invoice dates, and invoice amounts for the same billing period.
- Back Ordered Report – On a monthly basis, SDI must provide a report of all items that are on back order and the date that they are expected to be delivered or the date that they were delivered.
- Accuracy Detail Analysis Report – An itemized list of returned or rejected supplies by each school, with the option to submit the report to DOE on a monthly or a quarterly basis.

In addition, under its record retention requirements, DOE is required to maintain copies of these reports for six years. Specifically, DOE is required to retain any “daily, weekly, monthly, quarterly, or other periodic fiscal reports, including, but not limited to daily funds report[s], daily cash report[s], statement[s] of monthly balances, recapitulation[s] of disbursements, and department reports.”

Despite repeated requests, DOE never provided us with copies of any of the required reports. A month after our initial request for these reports and for DOE’s subsequent reconciliations, DOE officials advised us that they only requested the reports on an “as needed basis” and that the Quarterly Spend Report was requested annually rather than quarterly. Later, DOE officials informed us that they had never requested the required Back Ordered Reports or Accuracy Detail Analysis Reports. Instead they asserted that they addressed back order and accuracy issues as they occurred and that problems in these areas were infrequent. In addition, DOE did not provide any evidence of reconciliations of purchase data provided by SDI. Thus, DOE was not able to answer questions that arose as we tried to determine the total purchases made during Fiscal Years 2011-2013. Instead, DOE informed us that they needed to consult with SDI in order to provide the requested information.

Over the course of our audit, DOE provided three different sets of numbers of the amounts it had spent on purchases. DOE officials eventually informed us that “DSF received data requested from SDI. In reviewing that data we determined that SDI had not used the correct data sources in attempting to respond to the audit questions. SDI has requested additional time to re-evaluate and re-submit its response. Due to the complexity of the data extracted by SDI, additional time will also be required by DSF to analyze SDI’s information prior to submitting responses to the Comptroller’s Office.” Had DOE performed its own reconciliation as required by the contract, accurate information in response to our requests would have been readily available to DOE.

To date, due to the inconsistencies in the data received from DOE, we have been unable to determine the total dollar amount spent on custodial purchases between July 1, 2010 and June 30, 2013, the audit period. In an attempt to obtain that information, we provided DOE with a sample of 12 of the 575 variances we identified from the custodial purchases, totaling \$450,214. After five weeks of research, DOE advised us that six of the 12 variances, totaling \$406,135, resulted from SDI inadvertently listing custodial purchases acquired for its own use together with the quantity purchased by DOE. We were further told that four variances, totaling \$57,747, resulted from overbilling by SDI and that the remaining two variances, totaling \$13,668, resulted from a price change for substituted items, a change that DOE would have been aware of had it been keeping track of price and quantity changes.

DOE’s failure to require the submission of contractually-required management reports may have resulted in additional increased costs to the agency beyond those described above because absent such information, DOE would not have been able to determine if it is eligible to receive certain discounts. Pursuant to the contract, DOE is entitled to request discounts on future orders if there is a 20 percent or greater increase in the purchase volume for high usage items and 50 percent or greater increase in the purchase volume for catalog items. However, DOE’s failure to provide consistent purchase data or any Usage Reports in connection with this audit suggests that DOE would not be able to detect an increase in purchase volume that would have entitled it to a reduction of prices.

In addition, DOE appears to have also failed to review purchase and payment information in connection with its prior custodial supply contract with SDI. This failure would have potentially had an impact on the current contract with SDI because, according to DOE, the \$88.1 million

estimated budget for the 2010-2015 contract period was based on figures contained in the Fiscal Year 2009 Usage and Spend Reports required by the prior contract. When we requested these figures, however, DOE stated that it had to obtain this information from SDI, notwithstanding the fact that DOE should have had that information readily available. DOE, after contacting SDI, told us that the agency spent \$19,757,734 during Fiscal Year 2009. However, we were unable to retrace and recreate the numbers provided by DOE officials due to inconsistencies in the documents they provided. DOE officials subsequently claimed that upon their review of data extracted by SDI, they realized that SDI had used incorrect terminology and that the actual amount spent for Fiscal Year 2009 was nearly \$10 million dollars more than the \$19,757,734 we had been told and that was supposedly relied upon in connection with the estimates that formed the basis for the current \$88.1 million contract with SDI. Such a discrepancy calls into question the accuracy of the numbers used to create the budget for the current contract.

Insufficient Review of Key Performance Indicators

In accordance with the terms of its contract, SDI was required to submit to DOE a semi-annual contract report, highlighting key performance indicators, identifying problems that occurred during the previous six months, and forecasting future contract performance. DOE and SDI officials were then required to meet, formally discuss significant issues, and create mutually agreed upon resolutions. When we requested the semi-annual contract reports for Fiscal Years 2011 through 2013, DOE responded that “reviews are conducted at our annual pre-catalog meetings with the SDI data provided in a manner most useful to DSF and its development of the upcoming year’s program and catalog. . . . Unfortunately we did not retain this information, but have taken note to do so in the future.”

In an effort to substantiate the review process, DOE later provided us with some of its email correspondence with SDI related to the pre-catalog meetings. However, we found that the communication between SDI and DOE in this correspondence focused exclusively on the standard custodial supply negotiations related specifically to product availability and prices, all of which were required to be executed during the catalog’s development stage. We found no communications related to the overall performance indicators. In addition, the catalog meetings took place once a year during the development of the new catalogs, whereas the review of the semi-annual contract reports, as indicated by the name, is supposed to take place on a semi-annual basis. These reports are significant in that they are key indicators of SDI’s performance during the previous six months. DOE lost out on an opportunity to be made aware of issues that occurred earlier in the year and to develop corrective measures to address those issues in a more expedient manner by only meeting with SDI on an annual basis, and then only to discuss the development of the upcoming year’s program and catalog.

According to §4-05 of DOE’s PPP Guidelines (“Contractor Performance”), “Performance evaluations of contractors shall evaluate the degree to which the contractor’s performance has conformed to the requirements of the contract, including, but not limited to quality and timeliness of performance and fiscal administration and accountability.” As part of the oversight process, it was imperative that DOE obtained, reviewed, and reconciled the management reports and reviewed key performance indicators and resolved any discrepancies or deficiencies. Doing so would not only have allowed DOE to more effectively evaluate SDI’s compliance with the contract, it would also have contributed to SDI’s understanding of DOE’s goals and expectations, thereby reducing the likelihood for poor performance. Although DOE claimed that SDI was meeting the expectations set forth in the contract, without evidence of DOE’s review of SDI’s performance or of any efforts to address issues noted during the course of such reviews,

we were unable to verify DOE's claims that problems were kept to a minimum and were immediately addressed.

Recommendation

3. DOE should adequately monitor its contract with SDI in accordance with the terms of its contract. Specifically, DOE should: (a) review all management reports and semi-annual contract reports within the required timelines; (b) require the production of sales data from SDI; (c) conduct reconciliation of data contained within the data and the reports; and (d) discuss discrepancies and deficiencies with SDI in a timely manner.

DOE Response: "Although it is correct that not all reports that could have been obtained under the contract were in fact obtained from SDI, the DOE's contract with SDI has been monitored adequately. . . . Nonetheless, the DOE agrees that the recommendation warrants consideration."

Auditor Comment: The timely review of management reports from contractors is an important oversight tool in monitoring a contract. By not obtaining these reports, DOE has missed an excellent opportunity to closely monitor SDI's contract performance. Nevertheless, we are pleased that DOE agrees to at least "consider" this recommendation and urge DOE to adopt our recommendation so that going forward, both it and SDI comply with the terms of their contract.

Inadequate Assurance of Market Prices

According to the terms of its contract, in the event that DOE finds better market prices, the agency has the right to request price reductions. If DOE discovers that catalog items can be purchased elsewhere at a savings of 20 percent or more, DOE also had the right to request a price reduction within the price range offered by the alternate source. Furthermore, as stated earlier, DOE is also entitled to request a discount on future orders if it discovers a 20 percent or greater increase in the purchase volume for high usage items and a 50 percent or greater increase in the purchase volume for catalog items. In response to our requests, DOE provided price reductions for 192 of about 5,325 catalog items⁷ for Fiscal Years 2011 through 2013. However, due to lack of documentation provided by DOE, we were unable to ascertain the reasons for these price reductions; that is, whether they resulted from the custodians having found better prices, whether they resulted from DOE's efforts to compare SDI prices to those on the market, or whether the discounts were offered directly by the manufacturer. Moreover, despite numerous requests, DOE officials did not provide us with sufficient evidence to demonstrate that they were actively checking the market to determine whether they could obtain better prices than what they were currently paying through SDI.

When we asked DOE officials to explain how they could be certain that the prices paid to SDI were fair and comparable to market value, the agency responded as follows: "Pricing was established at the time of the bid when the DOE selected the lowest responsible bidder based on the publicly read bid. Pricing was fixed for the first two years of the contract." However, as noted above, the other five bidders were deemed to be non-responsive, and the comparison of SDI's bids to market prices prior to the awarding of the contract was not an adequate reflection of market prices. Moreover, there was also no evidence that DOE has made any comparison of SDI's prices to market prices since the contract was awarded.

⁷ These are items included in annual catalogs prepared by SDI. These catalogs differ from the list of 100 catalog items selected by DOE for the bidding process.

DOE officials further stated that “Upon commencement of the third year, pricing was adjusted based on the change in the Producer’s Price Index [PPI].”⁸ DOE stated that price adjustments were also made in the fourth year of the contract. However, when we asked DOE officials in December 2013 for the analyses conducted to determine the necessary price adjustments for the third and fourth years of the contract based on changes in the PPI, they were unable to immediately provide us with those calculations (for the third and fourth years of the contract), which should have been completed by May 2012 and May 2013, respectively. We did not receive the requested analyses until February 2014, which was *after* we had informed DOE of our findings and 21 months after the analysis should have been completed for the third year and nine months after it should have been completed for the fourth year. Accordingly, we lack assurance that the analyses for the PPI were conducted at the commencement of the third and fourth years of the contract as required or that they were used as a basis for any price adjustments that may have occurred.

DOE also claimed that it used the feedback and complaints received from custodians to initiate contact with SDI and to “help satisfy any need for monitoring price.” However, DOE did not provide us with any evidence of communication between the custodians and DOE in relation to obtaining better prices, notwithstanding a specific request for such information. DOE officials also said that custodians had an opportunity to raise issues pertaining to prices during their bi-monthly meetings with DOE’s deputy director of facilities. However, DOE failed to provide us with supporting evidence of those meetings or of any action that resulted from them.

Finally, DOE claimed that one of the benefits of entering into a contract with SDI was the fact that “a single contracted source provides DSF with a means of obtaining purchasing trends and cost data.” However, DSF was unable to provide us with the purchasing trends and cost data that should have been readily available for the duration of the contract. Thus, it appeared that DOE had not been monitoring purchasing trends or performing any type of cost data analysis, such as a comparison between SDI and market prices.

Recommendations

4. DOE should track and compare market prices to the current contract prices and, when applicable, request a reduction in prices.

DOE Response: “DSF management regularly requests, and is granted, reductions when prices appear to be inconsistent with those in the current market . . . Indeed, DSF had provided the auditors with instances where SDI had reduced prices upon DOE’s request.”

“The new [Deputy Director for Materials Management’s] scope of duties will include more comprehensive monitoring of market conditions and price comparisons with a view to requesting price reductions as appropriate.⁹ Additionally, DOE intends to continue to seek and use information provided by custodian engineers by alerting SDI to any pricing anomalies found in the catalog.”

Auditor Comment: Despite repeated requests during the course of our audit, DOE did not provide us with information about any specific instances in which DSF requested or obtained price reductions. In addition, contrary to DOE’s assertion that it will *continue* to seek and use information provided by custodian engineers as a means of alerting

⁸ The PPI measures the average change over time in the selling prices received by domestic producers of goods and services from the perspective of the seller.

⁹ DOE officials informed the auditors that the position of Deputy Director for Materials Management is currently open and that they intend to fill it.

SDI to price anomalies, we were not provided with any evidence that this ever occurred. Nevertheless, we are pleased that going forward, DOE intends to implement this recommendation.

5. DOE should develop a mechanism for obtaining and analyzing purchasing trends and price data relative to custodial supplies.

DOE Response: “The DOE intends to implement this recommendation once the new DDMM is in place.”

DOE Lacks a Formal Complaint Tracking System

DOE does not formally track complaints that it receives from custodians and so we were unable to form a conclusion as to whether DOE resolves the complaints it receives from the custodians in a timely and appropriate manner as it claimed. On numerous occasions, DOE officials stated that they relied on custodians to bring any issues with SDI to their attention and that the custodians were their “eyes and ears in the field.” DOE officials also told us that custodians had made very few, if any, complaints regarding supplies purchased from SDI and that whatever complaints they did receive were immediately resolved by DSF via phone calls.

Because DOE does not track or maintain a record of complaints, we were not able to verify either of these two claims. In addition, as mentioned earlier in the report, DOE claimed that custodians had an outlet for expressing issues or concerns during their bi-monthly meetings with the deputy director of facilities. However, we were never provided with supporting evidence of issues discussed or the follow-up action taken as a result of those meetings and so could not verify this claim. As an alternative, we sent an electronic survey to all 772 custodians to obtain information about their experiences with SDI.¹⁰

Pricing was identified as a significant concern of respondents to our survey. In response to our question seeking the custodians’ comments on any custodial supply-related issues they encountered, 57 (27 percent) out of 215 custodians who responded to this question asserted that SDI was charging mark-ups that ranged from 5 percent to 34 percent, resulting in prices higher than what the custodians found on the open market from other sources. One custodian complained that he had purchased two parts for a boiler for \$249 each from a vendor other than SDI and when he sought six more through SDI, the vendor used one of the two open market vendors the custodian had originally used and charged \$333.45 (a 34 percent mark-up) for each part. As a result, according to the information supplied by this custodian, by purchasing the boiler part through SDI, the total cost for the six items was increased by approximately \$507. Another custodian said that “after finding vendor & price information and informing SDI, their quotes from the same vendor and identical product(s) are frequently substantially higher.” When we discussed this issue with DOE, officials stated that mark-up charges were not allowed. However, DOE provided no evidence of controls that it had to ensure that SDI did not charge mark-ups.

In response to our question asking how frequently custodians found better prices on the open market, 524 (94 percent) of the 557 custodians who responded to this question said that they often or sometimes found better prices on the market.¹¹ One custodian complained that even after doing the research and finding cheaper prices in the market, if SDI did not have a relationship with that vendor, SDI would not use that vendor or provide the product at the lower

¹⁰ We conducted no audit tests to verify the responses provided by the custodians.

¹¹ Seventy-one percent of the custodians responded that they often found better prices and 23 percent of the custodians responded that they sometimes found better prices.

price. Rather, he said that he would be quoted a price from whichever vendor SDI did have a relationship with and that it could be substantially higher than the price the custodian found. Still another custodian said that “in the beginning I used to get crazy because I know many products are cheaper elsewhere, but I follow the rules. Unfortunately with the budget cuts so severe it makes it very hard to run the building properly. A penny saved is a penny earned.”

We also asked which factors, other than price and quality, were important to them when making purchases. Of the 581 custodians who responded to this question, 545 (94 percent) cited the availability of items and the timeliness of delivery. However, DOE does not track to what extent custodians are experiencing problems with availability and timeliness.

When responding to the question of possible ways in which the procurement process could be improved, 400 (89 percent) of the 448 custodians said that DOE should award contracts to one or more other vendors in addition to SDI. These custodians stated that having additional vendors would produce competitive pricing, help increase the timeliness of delivery, and improve the overall quality of service, while still maintaining the necessary controls over purchasing. Custodians also referred to several other vendors used by SDI that offered lower prices. The custodians questioned the benefit of using a “middle man” to make the purchases, thereby incurring additional fees that they said could be used to improve school maintenance.

The responses to our survey focused on various other areas of concern, all stemming from issues related to SDI, such as inadequate descriptions in catalogs, slow delivery times, and problems making returns. As indicated by their responses, the custodians had a range of concerns as well as suggestions for improving the current process of procuring supplies. However, we found no evidence that DOE formally solicits input from custodians pertaining to their satisfaction with services provided by SDI. Gathering feedback from the custodians, who were the people most directly affected by DOE’s contract with SDI, could help DOE identify expectations, satisfaction levels, and key shortcomings in the services provided.

Because DOE relied on an informal method of dealing with custodian complaints, it had no way of categorizing the complaints by type of concern, identifying trends and patterns, or ensuring that proper follow-up action was taken. If DOE had a formal tool to manage and track complaints, it could monitor whether complaints were resolved quickly and appropriately as well as identify recurring patterns of complaints related to a specific issue that might have warranted further attention.

DOE Response: DOE, in its response, objects to the survey, in part because we did not seek to verify the results, stating that the “Report cites survey responses, complete with dollar figures, percentages, and anecdotes, as if they were meaningful, reliable, and supportable.”

Auditor Comment: As indicated earlier in the report, the survey was undertaken to learn what complaints the custodians might have had because DOE did not retain any record of the complaints it received for the auditors to review. We draw no conclusions based on the responses to the survey other than to suggest that if there were a formal tracking system for complaints, DOE would be better able to resolve individual problems in a timely manner and to identify trends, which in turn would allow DOE to more effectively monitor the contract.

Recommendations

6. DOE should develop and implement a formal complaint tracking system that would provide custodians with a vehicle for expressing their concerns and observations and that would provide DOE the ability to track complaints and determine trends and patterns that need to be addressed, such as mark-up costs inconsistent with the contract.

DOE Response: “The DOE will develop a complaint tracking system that will capture custodian engineers’ concerns as they pertain to pricing, deliveries, product satisfaction and other aspects of the supply contract and to allow aggregation of data to identify system-wide supply procurement issues.”

7. DOE should explore methods that can be used to establish better communication with its custodians about the purchase of custodial supplies, including the use of surveys, forums, and complaint forms.

DOE Response: “We agree with the recommendation in part. As stated in the DOE’s response to Recommendation 6, a new complaint tracking system will incorporate a ‘complaint form’ on which custodian engineers can report their specific concerns relative to procurement.”

DETAILED SCOPE AND METHODOLOGY

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. This audit was conducted in accordance with the audit responsibilities of the City Comptroller as set forth in Chapter 5, §93, of the New York City Charter.

The scope of this audit covers the contract period of July 1, 2010, through June 30, 2013.

To develop an understanding of DOE's contract procurement process, we conducted a walk-through with the executive director of DCP, who provided an overview of DOE's contract procurement and award process. We also interviewed DCP's chief administrators of the following units: Transportation, Food, and Facilities; Vendor Research & Price Analysis; and Policy and Public Affairs. During these meetings, the chief administrators provided information pertaining to the contract procurement and award process, including the preparation and approval of the executive summary; the tabulation and verification of bids; the cost price analysis; vendor background checks; the selection of the lowest responsive and responsible bidder; and the contract registration process. We also learned, through walk-through demonstrations conducted by the Policy and Public Affairs unit, of the process DOE used to electronically monitor its contracts through its Contract Tracking System.

To develop an understanding of the day-to-day monitoring and oversight process of the contract, we met with the DSF field operation director and the director and deputy director of facilities, who described the design of the contract, the preparation and distribution of the supply program catalogs to the custodians, the methods used to provide funds to each school, and the approval process for supplies purchased on the market. In addition, we met with the director of finance, whose unit is responsible for the creation of the budget and for the payment of purchases.

To obtain an understanding of the policies, procedures, and regulations governing DOE's purchases of custodial supplies, we reviewed the following: DOE Custodial Supply Management RFB Contract # 20119170091; DOE PPP; Custodian Collective Bargaining Agreement for 2007; Custodian Supply Catalogs and Tool Box; and Custodial Supply Circulars. We also reviewed DOE's prior RFP contract #20049400971 for the provision of Custodial Supply and Related Services awarded to SDI.

To determine whether DOE's Custodial Supply Management Contract was awarded in accordance with its PPP requirements, we reviewed DOE's solicitation documents including a vendors outreach custodial supply list and the List of Interested Vendors. To determine whether there were any related entities or principal relationships (related party transactions) among the six companies that submitted bids and each company's principal officers, we compared the names of all six bidding companies and the titles of each company's principal officer to various databases such as the Comptroller's Omnibus Automated Image Storage and Information System, the Department of State Division of Corporations, the City of New York's Financial Management System, and the City's Vendor Information Exchange System.

We also requested the original bids submitted by vendors in hard copy form as well as the electronic. However, DOE was not able to locate the original bids. We analyzed the six

electronic bids received by DOE; however, because we did not have the original vendor bids to compare them against, we could not determine whether there were inconsistencies between the original bids and the electronic versions of those bids. We reviewed the electronic bids to determine the sufficiency of the number of items that were bid on by the competing vendors for each of the 300 most frequently used items (Subclass A items) as well as the discounts offered on 100 catalog items (Subclass B items). We also reviewed the electronic bids to determine whether the lowest qualified bidder had been selected.

In addition, we attempted to verify the accuracy of the data received from SDI pertaining to DOE's Fiscal Years 2011 through 2013 custodial supply purchases. This included the supplies purchased by the custodians for the three years, itemized by the description, quantity, unit of measure, unit amount (cost), and net amount (total cost). However, upon review of the data, we found variances totaling \$653,334 of which \$552,000 was acknowledged by DOE. Because DOE provided conflicting explanations and insufficient supporting documentation to substantiate those explanations, we were unable to verify the accuracy or completeness of the data received.

To determine whether DOE performed a reconciliation of payments made for custodial supply purchases, we requested DOE's Fiscal Years 2011 through 2013 custodial supplies purchases and expenditures and the four management reports: Custodial Supplies Quarterly Spend Report, Back Order Report, Accuracy Detail Analysis Report, and Detailed Usage Report. However, DOE did not provide any of the requested reports or evidence of reconciliations. To ascertain to what extent DOE monitored SDI's performance, we requested the Semi-Annual Contract Reports. However, DOE did not maintain any such records.

We attempted to determine whether the price terms contained in SDI's contract were at market value. We compared 85¹² of the 300 most frequently used custodial supply items from SDI's 2010 bid prices and from SDI's 2013 actual prices to the 2010 and 2013 prices in New York City's Department of Citywide Administrative Services requirement contracts. However, we were unable to draw a meaningful conclusion because of the variation in the dimensions and differences in the functional capacities of the products.

To assess the satisfaction of those directly affected by DOE's contract with SDI, we surveyed all 772 school custodians. The survey was conducted electronically and consisted of 22 questions. We received responses from 610 custodians. We conducted no audit procedures to confirm the responses provided by the custodians.

The results of the above tests, while not statistically projected to their respective populations, provided a reasonable basis for us to assess the adequacy of DOE's controls over the purchasing of custodial supplies.

¹² We judgmentally selected, based on the highest amount spent per category, five items in each of the 17 highest usage categories, for a total of 85 of the 300 items.



Kathleen Grimm
Deputy Chancellor

June 13, 2014

Ms. Marjorie Landa
Deputy Comptroller for Audit
The City of New York
Office of the Comptroller
One Centre Street
New York, NY 10007-2341

Re: Audit Report on the Department of Education's Custodial Supply Management Contract with Strategic Distribution, Inc. (MG13-079A)

Dear Ms. Landa:

This letter, with the attached response to recommendations ("Response"), constitutes the formal response of the New York City Department of Education ("DOE") to the City of New York Office of the Comptroller's ("Comptroller") draft audit report titled *Audit Report on the Department of Education's Custodial Supply Management Contract with Strategic Distribution, Inc.* ("Report").

As this Response reflects, DOE management does not agree with reported conclusions concerning the procurement of the Strategic Distribution, Inc. ("SDI") contract and takes exception to the Report's publication of custodian engineers' unverified survey responses. Further, while we can agree that certain SDI contract monitoring functions have not been tracked expressly as written in the agreement, for the reasons elucidated below we reject the implication that monitoring efforts were wholly lacking.

DOE is confident that any concerns regarding administrative oversight of the SDI contract will be addressed fully when the Division of School Facilities ("DSF") Deputy Director, Materials Management ("DDMM") position, which currently is posted, is filled. It is intended that the position will interact regularly with SDI and custodian engineers to ensure compliance with contractual monitoring/reporting requirements; compliance with product specifications; cost reductions and service improvements as applicable; regular analysis of product usage and delivery trends; support with non-catalog purchases; accurate invoicing; avoidance of catalog/non-catalog pricing discrepancies; annual catalog pricing modifications as applicable; and, complaint resolution.

The DOE is confident as well that the decision to enter into the integrated supply arrangement has resulted in substantial cost savings while addressing the significant

control deficiencies inherent in the open market approach to custodial supply purchasing that formerly had been in practice. The following provides the framework for the DOE's position.

Custodian Engineer/DOE Relationship

Custodian engineers function in a quasi-independent contractor relationship to the Department which is defined by a collective bargaining agreement ("Agreement") between the Department and Local 891 of the International Union of Operating Engineers, AFL-CIO ("Local 891").¹ Pursuant to the Agreement, custodian engineers receive an annual operating allocation in bi-weekly installments from the Department based upon schedules defined in the Agreement. From the allocation, custodian engineers hire and pay staff that work directly for them. Through efficiencies, they can purchase goods and services necessary for compliance with contractual maintenance requirements and derive their personal compensation up to a contractually established maximum permissible retainage (MPR). Since the MPR is not guaranteed, it can be achieved only through operating efficiencies.

Custodial labor, goods and services direct expenditures are captured on specific reports that the Department audits annually to determine whether those expenditures are properly documented and whether the custodian engineer has retained an amount in excess of the MPR. Audit disallowances and excess retainage are recouped. If the custodian engineer retains less than the contractually set MPR, the Department does not make up the shortage.

Integrated Supply Contract: Background

The Report generally does not challenge the wisdom of the DOE's engagement of an integrated supply contractor such as SDI, whose clients include multi-national corporations. However, since the Department is concerned that the Report's discussion of records production issues may overshadow the sound reasons for and the objectives of such an arrangement—which, we are certain, largely have been realized—we offer the following to provide the public with context.

In 2003, the year that saw the first procurement of SDI's services, then Public Advocate Betsy Gottbaum published a statement titled "Procurement in New York City: A Strategy for Local Economic Development." In that piece Ms. Gottbaum noted that "[t]he reigning in of school purchasing autonomy is a reflection of the DOE's movement toward purchasing consolidation, in an attempt to improve its administrative and cost efficiency. Like many public procurement agencies around the country, the DOE has been

¹ Custodian Engineer is a civil service title. Credentials for the position are defined at <http://www.nyc.gov/html/dcas/downloads/pdf/noes/201303057000.pdf>

experimenting with strategic sourcing. In January 2002, it began the Vendor Commodity Analysis (VCA) project. VCA is geared at helping the DOE utilize the strength of its purchasing power to negotiate less costly contracts with larger suppliers.”² Although the statement focused on schools’ purchasing power, the same concerns about adherence to bidding practices, obtaining best overall pricing, creating reporting mechanisms, and generally improving controls over procurements, applied to DSF’s operations.

It was a particular concern among the DSF managers that the then-current policy of allowing custodian engineers to make purchases as they saw fit had been shown through a number of high-profile law enforcement agency investigations to have facilitated corrupt purchasing practices among certain custodian engineers, which practices included self-dealing, creating bogus bids and obtaining inflated or otherwise false invoices from supply vendors and obtaining, but not recording refunds, on purchased merchandise. In announcing prosecutions for those illicit activities, the Attorney General and Commissioner of the Office of Special Commissioner of Investigation for the City School noted that “the current procurement system for the BOE custodians encourages corruption and impedes oversight largely because custodians have immense latitude in spending money earmarked for the maintenance of schools, and because oversight of bidding procedures conducted by nearly 850 individuals is extremely difficult.”³ Thus, in addition to leveraging the collective power of both the central custodial spend as well as the direct purchases made by DOE’s custodian engineers; providing a mechanism for garnering otherwise unobtainable commodity-level aggregate purchasing information; and ensuring compliance with environmental and safe-product purchasing guidelines, the requirement that custodian engineers use a single contracted supplier for a critical mass of products effectively tamped down the potential for the various types of well-publicized misconduct.

Furthermore, as the benefit of the bidding process has already been applied “globally” to all purchases made from SDI, it is no longer necessary that custodian engineers obtain three bids for purchases that exceed \$250 or aggregate annual purchases totaling over \$2,500. In addition to saving custodian engineers the time it takes to obtain and document those bids—time better spent maintaining their school buildings—the global bidding process serves to prevent the opportunity for kickbacks, less-than-arm’s length dealing, returning items for cash or credit to be used personally, and over-invoicing to inflate/fabricate miscellaneous custodial expenditure claims.

² http://publicadvocategotbaum.com/new_policy/procurement.html

³ <http://www.ag.ny.gov/press-release/eleven-school-custodians-arrested-kickback-and-bid-rigging-scheme> and <http://www.justice.gov/usao/nye/pr/2005/2005may5a.html>

The benefit has been realized at the audit stage as well in that supporting documentation for purchases is readily at hand and rarely provides a basis for audit disallowances that often trigger a resource-consuming grievance process. And, a decline in audit disallowances means that the DOE does not have to engage in activities around recoupment of the dollars that already had been spent.

Integrated Supply Contract: Procurement

The Report asserts that the process that resulted in the award of the custodial supply contract to SDI was not competitive, citing as support for that assertion missing paper bids and instances of what were clearly administrative errors made on records transmitting information about the procurement process. The DOE acknowledges that the paper bids could not be retrieved and that a minimal number of administrative errors unfortunately occurred. Nonetheless, it is the DOE's position that the conclusions drawn in the Report from those circumstances are wrong and that, based on the following, the DOE engaged in an effective bid solicitation that supported a competitive procurement process:

- The "Vendor Outreach List" identifies roughly 130 entities that received notification of the Request for Bid ("RFB").
- The "Vendor Download List" maintained by the DOE Division of Contracts and Purchasing ("DCP") shows that approximately 110 entities downloaded the RFB.
- The "Pre-Bid Conference" sign-in-sheet was signed by individuals representing 22 entities.
- The "Bids Received Log" reflects the receipt of six bids.

A second prong of the auditors' SDI contract procurement process review involves an assessment of the DOE's pre-award price analysis. Their conclusion that the price analysis was "inadequate" fails to take proper account of what was a reasonable review of available information and, further, discounts the fact that, while bids other than SDI's were determined to be non-responsive, two of those other bidders provided pricing information sufficient to enable the DOE to assess and compare their bids with those submitted by SDI.

To accomplish the price comparison DCP identified 300 high usage items for which vendors were required to quote individual prices. Two of the six vendors submitted bids with unit prices for all 300 items (SDI and Sunshine) and a third (Marjam) bid on 292 of the 300 items. Using the 292 items on which all three bid, the following results were obtained:

- Marjam's total for the 292 items was \$20,062,885.19 (Rank: 3)
- Sunshine Lighting's total for the 292 items was \$14,906,621.47 (Rank: 2)

- SDI's total for the 292 items was \$14,294,074.53 (Rank: 1)

Accordingly, SDI's pricing on the same products was 29 percent lower than Marjam's and 4 percent lower than Sunshine's.

DCP conducted another layer of research by attempting to compare pricing for the 300 items with pricing in state Office of General Services ("OGS") contracts with two large supply companies, Grainger and MSC Direct. While only 15 of the tested items appeared in the OGS contracts with those companies, SDI's unit pricing was found to be the lowest on 10 of the 15 items.

The Report additionally points to what is characterized as conflicting information provided by DOE staff regarding whether a market basket analysis was conducted in furtherance of the contract award process. DCP management cannot now identify the source of the miscommunications, but can offer that, in fact, the market basket analysis, which was provided to the auditors on March 6, 2013, was conducted and was a relevant consideration in the award decision.

To further the market basket analysis, vendors were required to provide a percentage discount off their latest distributor catalog(s) and price lists. Following the protocol established for this procurement, the DSF selected a random sample, that is, a "market basket," of approximately 100 generic items specific to the DOE's needs in sixteen 16 categories, available in commercial catalogs. The bidders did not have prior knowledge of which items would constitute the market basket. Prices for the 100 items were compared by applying the discounts offered by each vendor to their respective catalog's prices. Since only SDI and Sunshine offered pricing for the market basket items that also appeared in their catalogs, the comparison was made between those two companies. SDI offered a discount of 10 percent to 50 percent on various categories in its General Catalog, while Sunshine offered discounts of 10 percent to 15 percent on four categories with no discounts on the balance. For the 56 items on which both vendors offered pricing, after the discount, SDI's pricing averaged 13 percent lower than Sunshine's.

The Report's broad assertion that the award was not in accordance with DOE policies and procedures is difficult to rebut as the particular policies or procedures that were purportedly not followed are not specified. However, as the above-outlined process well demonstrates, there is clear and conclusive evidence that the award to SDI derived from an open and competitive procurement and that advantageous pricing was secured. And, as a final word about pricing, we note that SDI's pricing for high usage items was 13 percent lower than that of its prior contract, which was also competitively let.

SDI Contract Oversight

It is necessary and reasonable to address statements in the Report that assail the DOE for having failed "to provide complete and accurate information concerning purchases made pursuant to the contract," and to require production of reports referenced in the contract. Those thoughts are then tied to an observation about DOE's "lax" contract oversight in general as if those thoughts followed from one to the other. (Report, p.7).

Custodial Supply Program v. Direct Billing

As acknowledged by the auditors, the custodial supply contract is utilized to provide essential supplies under both the centrally administered custodial supply and the direct bill programs. More particularly, SDI's Custodial Supply Management Contract with the DOE supports two operational requirements at the DSF: the Custodial Supply Program and what we refer to as the Direct Bill purchasing program. Under the Custodial Supply Program, the DSF centrally funds school buildings with pre-determined allocations. Prior to the program's rollout, each building's supply allocation is shared with SDI and is loaded into their central database. Similar to a debit account, custodian engineers place orders with SDI drawing down on these funds from their individual building accounts. Custodian engineers place their orders through the established supply and toolbox catalogues. In the event a custodian engineer wants to order an item that was not listed in the catalogue, (s)he could purchase non-catalogue items through this program. All purchases under the Custodial Supply Program must be procured through SDI. Once custodian engineers reach their building's pre-determined annual supply allocation threshold they can no longer order supplies under that year's program. All items procured under the Custodial Supply Program are invoiced to, and funded by the DSF, centrally. Reports of Custodial Supply Program purchases are thus readily available to the DOE.

Separate and apart from the Custodial Supply Program procurement methodology, custodian engineers can purchase supplies utilizing funds from their building operating budgets through the Direct Bill process. Under this method, custodian engineers may purchase supply materials using the same catalogues established for the Custodial Supply Program. Custodian engineers can also purchase non-catalog items and may even purchase supplies from other vendors, provided they follow the Department of Education's procurement procedures. Purchases made under the Direct Bill process must be entered by the custodian engineers on miscellaneous expenditure forms and submitted to their supervisors, the Deputy Directors of Facilities, for review and approval. All items purchased under the Direct Bill process are invoiced directly to the custodian engineer and are paid for directly from their building operating budgets. If the

purchase is made from SDI, it is not the DOE, but SDI that will have the relevant information which can be reported to the DSF management for review and analysis.

With respect to the centrally administered Custodial Supply Program, DOE provided detailed information to the auditors showing the exact amounts spent during the past three fiscal years. During audit fieldwork the auditors also were provided with several documents, including the following:

- Custodial Inventory Monthly Audit Guidelines
- Detailed itemized bills which are received monthly from SDI
- Examples of the monthly audit selection process
- Examples of individual school audit responses
- Data documenting the monthly discount for prompt payments. (The discount totaled \$214,261.19 for Fiscal Year 2013.)

Contract Monitoring Activities

One of the Report's themes is that the DOE has not taken a serious approach to its SDI contract oversight responsibilities. Though we agree with certain audit recommendations for additional controls, we note that those controls merely will supplement the monitoring procedures that are already in place and functioning quite satisfactorily. Those current monitoring efforts include review of SDI reports, regular face-to-face interaction with custodian engineers and their representatives, billing reviews and price checks.

With respect to SDI-generated reports, each year the DSF managers conduct a review of the effectiveness of the contract primarily by analyzing annual spend and detailed usage reports, which are utilized to develop the following year's catalog and program.

Another means by which information about contract implementation is garnered rests on the working relationship between the custodian engineers and the DOE, which is managed by the DSF's Deputy Directors, who meet with custodian engineers at least every other week to distribute payroll, review division-wide issues/initiatives and address custodian engineer's concerns. It is during these meetings that custodian engineers have the opportunity to raise matters related to the custodial supply program. If a procurement issue cannot be resolved at the field level, it is escalated to senior DSF management for further action.

Open lines of communication also have been furthered by Local 891's designation of chairperson positions that cover various areas of responsibility within the custodial system. One such position, "Supply Chairperson," is held by a custodian engineer who serves as Local 891's representative to address SDI contract issues. During the school year, the Supply Chairperson will contact the DSF Director of Field Operations if a

problem with SDI could not be resolved by the custodian engineer. In such cases, the Director of Field Operations will contact SDI directly and negotiate a resolution. On an annual basis, preparatory to the publication of a new supply catalog, the Supply Chairperson and Director of Field Operations discuss what changes, if any, are warranted and whether new products should be added to the catalogue based on needs identified by Local 891's constituents.

Audits of invoices SDI submitted to the DOE for payment of supplies sent to custodian engineers through the centrally administered custodial supply program are conducted monthly by the DSF on a sample basis. The items identified by SDI as having been ordered by the randomly selected sampled schools are confirmed in writing with the assigned custodian engineers. Should there be a discrepancy, it is addressed immediately with SDI, either by ensuring that the item in question is sent to the school or that a refund is obtained. We are pleased to state that discrepancies occur very rarely and are always rectified quickly.

Although we acknowledge that price analysis information was not provided timely to the auditors by the DSF, it is unreasonable to assume that such analysis did not occur. To explain, the SDI catalog prices were determined through the actual bid and award process and were valid for the first two years of the contract. After that, catalog pricing was determined through the Producer Price Index (PPI) program⁴ as defined under the contract. Between the contract base year of May 2010 to the month used to compare changes in the PPI (April 2012) the PPI grew by 10.2 percent. Notwithstanding that growth, the average SDI catalogue price increase amounted to only 7.36 percent. Between 2012 and 2013 the PPI grew by .79 percent, but the price increase was set at .64 percent. On a \$10,000,000 spend the savings would be \$284,000 in the first year of the increase year and \$15,000 in the last year of the audit period when there was very little movement in PPI prices

In sum, contrary to the auditors' assertions, contract oversight is not lax in any respect. Moreover, through the DSF's efforts, which are consistent and ongoing, the DOE has gained confidence that SDI has provided, and continues to provide, products at costs that are advantageous to the DOE.

The Audit Survey

The Department has no quarrel with the findings in this Report that were fairly reported. We are surprised, then, that having made certain of their points on the merits, the auditors saw fit to trot out the results of a survey that, rather than lend support to their

⁴ The Producer Price Index ("PPI") program measures the average change over time in the selling prices received by domestic producers for their output. PPI data is published by the United States Department of Labor Bureau of Labor Statistics

findings, serve to raise questions as to their intentions, especially considering that, by their own admission, those results were based upon statements that were in no manner confirmed. A few observations about that survey are in order.

Firstly, for context, it is useful to point out that the impetus for entering into a contractual relationship with an integrated supply vendor was not solely that the DOE sought to corral custodial supply costs. It included as well the pressing need to eliminate the opportunity for the persistence of corrupt procurement practices that had taken root in the free market arena and had resulted in a staggering number of dismissals and arrests of custodian engineers in the early 2000s. It is against that backdrop that the auditors draw conclusions from anonymous unverified and unaudited responses of those who did not voluntarily sign onto the use of a single source for procuring supplies, but were directed by the DSF to do so.

Most significantly, on the day the auditors emailed the survey to custodian engineers, Local 891 leadership emailed the membership advising them not to complete the survey until they received further instructions from their leadership. The Department was not privy to the substance of those further instructions—assuming they were forthcoming. Nonetheless, when inferences are drawn about what the survey responses suggest, the potential that those responses were influenced by Local 891 should be added to the other causes for skepticism about the results of the undertaking.

Secondly, it strikes us as curious that the while the Report stresses the Department's inability to provide evidence in support of its position in certain cases, and suggests that without such evidence, the representations of high-level Department officials is insufficient, that same Report cites survey responses, complete with dollar figures, percentages, and anecdotes, as if they were meaningful, reliable and supportable. As to those characteristics, we know that the auditors "conducted no audit tests to verify the responses provided by the custodians." (Report, footnote 9). We also know that the custodian engineers were not asked whether their concerns and/or complaints about pricing or timeliness of delivery were brought to the attention of the DSF managers or whether they had maintained any record in support of their assertions.

We posit that there is an art—and, arguably, a science—to creating audit survey questions that drive sensible, informative and reliable responses. In this case, however, the questions are so unartfully drawn that any reliance on the responses is misplaced. Our position is well supported by audit survey questions 12 and 13⁵:

⁵ Questions 14 – 17 merely provide space for the responders to offer additional examples.

12. When you have researched prices [from the open market prior to ordering supplies from SDI]⁶ how frequently have you found better prices on the open market than the prices charged by SDI?

- o Never
- o Rarely
- o Sometimes
- o Often

13. Please list an example that you can recall pertaining to the types of supplies that you found to be better priced on the open market (vendors other than SDI).

Item

Vendor Name

Vendor's Price

SDI's Price

Total

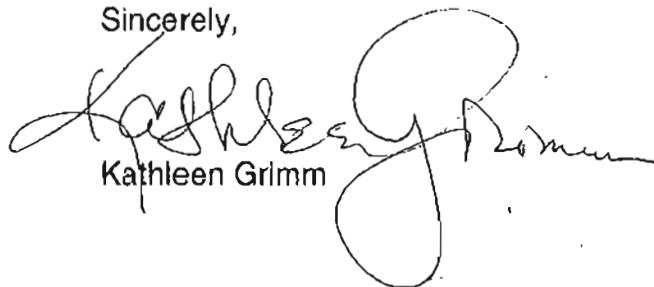
SDI contracts have been in place since 2003. The survey respondents had not been asked to identify when they might have found better prices on the open market, but were free to come up with examples from a period spanning roughly 11 years. An even greater obstacle to determining with any certainty whether a respondent's report that prices were lower in the free market is that the questions are so loosely worded that it is not possible to tell whether the respondent is reporting a comparison between products within same *category of item*, e.g., all-purpose cleaner, or the *same item*, e.g., "Simple Green" all-purpose cleaner. Does this matter? Of course it does. The agent in our example is used in public school buildings where all stakeholders derive a significant benefit—the value of which cannot be measured simply in terms of monetary costs—from requiring the use of a single contracted source that assures that the items offered for sale meet governmental "green" and safety standards.⁷ No such assurance can be

⁶ Question 12 continues from Question 11 that asks custodian engineers to assess the frequency of their research of prices on the open market ("Never," "Rarely," "Sometimes," "Usually," "Always").

⁷ See New York State and federal "green" standards at <https://greencleaning.ny.gov> and <http://www.greenseal.org/GreenBusiness/Standards.aspx?vid=ViewStandardDetail&cid=0&sid=23>

gained from an open market approach since, historically, that approach has not yielded wholly satisfactory outcomes on various measurements.

Sincerely,



Kathleen Grimm

Enclosure (1)

Cc David Ross, Executive Director for Contracts and Purchasing
Marlene Malamy, Deputy Auditor General
George Davis III, Deputy Director, Mayor's Office of Operations

June 17, 2014

NEW YORK CITY DEPARTMENT OF EDUCATION RESPONSE TO FINDINGS AND RECOMMENDATIONS

The following, with the attached cover letter from New York City Department of Education (“DOE”) Deputy Chancellor Kathleen Grimm, comprises the response to the City of New York Office of the Comptroller’s (“Comptroller”) draft audit report titled *Audit Report on the Department of Education’s Custodial Supply Management Contract with Strategic Distribution, Inc.* (“Report”).

Recommendation 1. *DOE should retain all pertinent documents related to the bidding process in accordance with its rules and policies.*

Response. The DOE agrees.

Recommendation 2. *Where there are a limited number of bidders, DOE should conduct additional steps, such as comparable market analysis, to ensure that the prices quoted in the bids are reasonable prior to deciding to award the contract.*

Response. The DOE agrees with this recommendation and asserts that in the case of the SDI contract procurement “additional steps,” including a comparable market analysis, were taken. That is why we are satisfied that the contract awarded was based on pricing that was fair and reasonable.

Recommendation 3. *DOE should adequately monitor its contract with SDI in accordance with the terms of its contract. Specifically, DOE should (a) review all management reports and semi-annual contract reports within the required timelines; (b) require the production of sales data from SDI; (c) conduct reconciliation of data contained with the data and the reports; and (d) discuss discrepancies and deficiencies with SDI in a timely manner.*

Response. Although it is correct that not all reports that could have been obtained under the contract were in fact obtained from SDI, the DOE’s contract with SDI has been monitored adequately. Before the next year’s catalogue is finalized, the DOE Division of School Facilities (“DSF”) managers perform annual reviews of SDI reports reflecting total spend and total usage. During the review period, a complete analysis of the prior year’s program is conducted and modifications are made to the catalogue as deemed appropriate. It has been the experience of DSF management that the annual reports generally have been sufficient for the purpose of informing the reviews.

Nonetheless, the DOE agrees that the recommendation warrants consideration. Therefore, when the Deputy Director for Materials Management (“DDMM”) position is filled a determination will be made whether more frequent review of the reports should be incorporated into the SDI contract oversight process.

Recommendation 4. *DOE should track and compare market prices to the current contract prices and, when applicable request a reduction in prices.*

Response. The contract with SDI provides for price reduction on a voluntary basis. DSF management regularly requests, and is granted, reductions when prices appear to be inconsistent with those in the current market, and DSF has confirmed that the items are identical or as-equal. Indeed, DSF had provided the auditors with instances where SDI had reduced prices upon DOE's request.

The new DDMM's scope of duties will include more comprehensive monitoring of market conditions and price comparisons with a view to requesting price reductions as appropriate. Additionally, DOE intends to continue to seek and use information provided by custodian engineers by alerting SDI to any pricing anomalies found in the catalog.

Recommendation 5. *DOE should develop a mechanism for obtaining and analyzing purchasing trends and price data relative to custodial supplies.*

Response. The DOE intends to implement this recommendation once the new DDMM is in place.

Recommendation 6. *DOE should develop and implement a formal complaint tracking system that would provide custodians with a vehicle for expressing their concerns and observations and that would provide DOE the ability to track complaints and determine trends and patterns that need to be addressed, such as mark-up costs that are inconsistent with the contract.*

Response. The DOE will develop a complaint tracking system that will capture custodian engineers' concerns as they pertain to pricing, deliveries, product satisfaction and other aspects of the supply contract and to allow aggregation of data to identify system-wide supply procurement issues.

Recommendation 7. *DOE should explore methods that can be used to establish better communication with its custodians about the purchase of custodial supplies, including the use of surveys, forums, and complaint forms.*

Response. We agree with the recommendation in part. As stated in the DOE's response to Recommendation 6, a new complaint tracking system will incorporate a "complaint form" on which custodian engineers can report their specific concerns relative to procurement.

The custodian engineers' ability to communicate complaints in a written, uniform format will supplement the open lines of communication that are already in place. In that regard, DSF management holds regular meetings with the custodian engineers' union Supply Chairperson to discuss ideas for improvements, address any issues with existing procurement processes and suggest additional or replacement products for the catalog. Additionally, Deputy Directors of School Facilities meet with custodian engineers at least bi-weekly during which time custodian engineers can raise concerns related to the custodial supply program.