Funding Centralized State Procurement Operations for South Carolina

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South Carolina Budget & Control Board

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Problem Statement

Title 11, Chapter 35, Section 810 of the South Carolina Code of Laws calls for the creation of, within the South Carolina Budget and Control Board, a Materials Management Office to be headed by the Materials Management Officer. Enacted in 1981 (Act No. 148), the South Carolina Consolidated Procurement Code and Regulation (The Code) is intended to centralize “all rights, powers, duties and authority relating to the procurement of supplies, services, and information technology...”\(^1\). With the creation of an office to monitor the consistent application of procurement law in South Carolina, the General Assembly provided a means to insure tax dollars are spent wisely and awards for contracts to provide goods and services are made fairly. The General Assembly did not address a preferred method of funding the operation of the Materials Management Office (MMO).

Today, MMO is a component of the Division of Procurement Services and includes the State Procurement Office, the Information Technology Management Office, the Office of Audit and Certification, and the Office of the State Engineer. Until 2003, these operations were funded solely through state appropriations. In 2003 an administrative fee clause was added to certain statewide term contracts. Revenue resulting from fee collections has been used since to supplement state appropriations and fund MMO operations. From FY 2004-05 to FY 2009-10 the amount of the state appropriation for MMO decreased 35%. In FY 2010-11 the appropriation was vetoed by the Governor with the veto sustained in the South Carolina House of Representatives.

The Governor’s veto of the appropriation for MMO (and its parent agency, the SC

\(^1\) SC Code of Laws; 11-35-510
Budget & Control Board) was restored after the SC Supreme Court ruled the Governor’s veto unconstitutional\(^2\). The prospect of no or inadequate funding of a critical government function warrants a review of funding practices observed in other states and discussion of the suitability of these practices to South Carolina.

This project will identify options available for funding a centralized procurement system in South Carolina and identify an option with potential to provide revenue sufficient to support a critical government function in most economic climates.

\(^2\) SC Supreme Court Opinion No. 26918
Data Collection

The primary goal of data collection for this project is to illustrate the diverse methods by which other states fund their centralized procurement offices. Additionally we hope to provide the basis for a discussion on whether South Carolina should consider changing the way it funds its central procurement office. The project will mainly reference two sources of data, both provided by the National Association of State Procurement Officials (NASPO):

The first source is the NASPO 2009 Survey of State Government Purchasing Practices. This survey collects data from states on the following points concerning services provided and the source of funding for centralized procurement offices.

The second source of data is the NASPO Research Brief titled Administrative Fees: Creative Funding for Central Procurement in Difficult Economic Times. This research brief provides background and explanation of the conditions leading to adoption of funding methods adopted by a number of states.

Data Analysis

The data from the 2009 Survey of State Government Purchasing Practices does not reveal a decisive preferred method among states for funding of their centralized procurement offices. In total 45 states responded to the survey. The survey requested information on the following topics:

- Funding source(s)
• Does the central procurement office charge state agencies for services provided by the central procurement office?

• What value added services are provided to state agencies?

• What is the basis for fees (if any) charged to state agencies for value added services?

• Does the central procurement office charge political subdivisions for procurement related services?

• If political subdivisions are charged, what is the basis for the fees?

• What value added services are provided for political subdivisions?

• What services are provided to state entities exempt from purchasing oversight?

• What value added services are provided to vendors?

• Does the state charge vendors for services provided by the central procurement office and what is the basis for the charge?

Funding Sources

Forty-four (44) states responded to the survey question inquiring how their central procurement offices are funded. Reported funding methods fell into one of three categories:

A. Appropriations: 41% (18 states) are funded solely with state appropriations

B. Appropriations/Self-funding combination: 34% (15 states) are funded with a combination of appropriations and revenue earned from operations. The Materials Management Office in South Carolina is currently funded this way.

C. Self-funding: 25% (11 states) are funded solely with revenue earned from operations
**Value Added Services to other state agencies**

Forty-two (93%) of the state central procurement offices reported providing some level of value added services to other state agencies. The top five value added services provided and the percent of respondents providing those services are:

- **Training** 87%
- **Specification or Solicitation Development** 53%
- **One-time purchase on behalf of other agencies** 40%
- **Consulting services** 29%
- **Maintenance of bidding systems** 11%

The South Carolina Materials Management Office provides the following value added services to South Carolina state agencies: Training, specification development, consulting, one-time purchases on behalf of other agencies, multi-agency purchases, access to state term contracts and multi-state cooperatives.

**Basis of Fees to State Agencies for Value Added Services**

Fifteen (33%) of the state central procurement offices provided information on the basis of fees charged for value added services. The most common basis (33% of those reporting) was a fee assessed on purchases from master contracts awarded by the central procurement office. Fees for training, fees based on cost recovery, and assessments based on annual spend data were cited by 13% of respondents. The South Carolina Materials Management Office charges fees for value added services through registration fees for training classes and administrative fees assessed on some statewide term contracts.
Charges to political subdivisions for value added services and their basis

Nine (20%) of the states responding report they charge political subdivisions for the value added services provided. A total of 98% of survey participants report providing some level of services to other political subdivisions in their state. The most commonly delivered services are:

- Availability of state purchasing contracts for use by other political subdivisions (98% of states in the survey)
- Electronic access to state contracts (91% of states in the survey)
- Staff expertise upon request (82% of states in the survey)
- Conducting procurements on their behalf (51% of states in the survey)

Eight of the nine states charging other political subdivisions reported on the basis of their fees:

- Cost Recovery (three of the states reporting)
- Fees on contracts (two of the states reporting)
- Subscription fees, fees based on population, & annual fees (one each reported)

The South Carolina Materials Management Office charges fees for value added services delivered to other political subdivisions through registration fees for training classes and administrative fees assessed on some statewide term contracts used by political subdivisions for the purchase of goods and services.
Implementation Plan

Of the funding methods reported in the 2009 NASPO Survey, the self funding model offers a high degree of flexibility and utility. The primary component of 33% used by the self funding offices was a fee charged on purchases from state contracts issued by those states central procurement offices. *The use of an administrative fee, often in the form of a transaction fee, is increasing in popularity as a source to fund central procurement programs in part or entirely.*

The Materials Management Office in South Carolina currently assesses a fee ranging from 0.75% to 1.00% on some statewide contracts. Administrative fees at this level generated $4 million dollars in Other Revenue for MMO in FY 2009-10. In order to become self funding, MMO would need to generate, from the collection of administrative fees on its statewide term contracts, enough revenue to completely fund its operations. The Division would need to generate an additional $1.1 million in Other Revenue for a total of $5.1 million, the amount of expenditure needed to support operations for each of the past two fiscal years. This could be accomplished by:

- An increase in the number of commodities available for purchase from statewide term contracts.
- An increase in the fee on contracts already in place.
- A combination of both.

Both tasks can be initiated by the Materials Management Office. As a Division of the South Carolina Budget & Control Board, MMO is authorized to do so by Sections 1-11-

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3 NASPO Research Brief: *Administrative Fees: Creative Funding for Central Procurement in Difficult Economic Times*, September 2009
335 and 11-35-4860 of the South Carolina Code of Laws (Appendix A). New contracts that state agencies may find useful include those for small package delivery, auto parts, industrial supplies, hand tools, lodging (for travel on state business) carpet/flooring, and elevator maintenance.

The timeframe for a change such as this is difficult to pinpoint. With appropriations likely to decrease in the coming fiscal year it is fair to assume FY 11-12 would be a good time to begin the migration to a self funding model. There are other factors to consider and will be addressed in a moment. The change would not increase the overall cost incurred by the state to support its centralized procurement office. A component of the new funding method would be, as fees from contracts increase to the point MMO becomes fully self funding, an equal amount of state appropriations would be given up, until the need for appropriated funding disappears completely.

Proponents of this change should expect objections to come from customers, users of statewide term contracts. While the customers may not object to additional statewide term contracts for commonly used items, they can be expected to object to increased fees, and their impact to the cost of items on statewide term contracts already in use.

Other stakeholders will be concerned that an increase in administrative fees on statewide term contracts will increase the burden on an already overburdened state budget. The response to both objections should emphasize the value of the contracts, statewide and one-time agency specific, issued by MMO. According to the Division of
Procurement Services FY 2009-2010 Accountability Report (Appendix B), those contracts have generated, in one year, $72 million in saving to state agencies and other political subdivisions in South Carolina.

The strategic goal is that as revenue from administrative fees increases, appropriations will decrease by the same amount, until such time MMO is completely self funded. The appropriations given up become available to other state agencies through the budgeting process. The cost to operate the Materials Management Office is born proportionately by state agencies and other political subdivisions depending on the extent to which they use the services (statewide term contracts) provided by MMO.

Surplus funds remaining at the end of the fiscal year should be managed to the benefit of the taxpayers. To secure the financial stability of the Division, a maximum carry forward amount should be established to provide for volatility in cash flow at the beginning of subsequent fiscal years. A maximum carry forward equal to one quarter of the prior fiscal year's expenditures (a ninety day supply of funds) should prove adequate, insulating the Division from an unexpected decrease in collections. The balance of the carry forward, in excess of a ninety day supply of funds, should be returned to the General Fund at the end of each fiscal year. This would prevent a cash balance from sitting on the books. The return to the General Fund of all surplus cash greater than the maximum carry forward can be accomplished with a proviso attached to each year's Appropriation Act.

The migration to a self-funding central procurement office should take place over a period of years, the length of time determined by the speed with which administrative
fees of statewide term contracts can be brought to a level that will completely fund the operation of the office. To increase fees on contracts currently in place would create a hardship on vendors. Stakeholders should recall that vendors do not pay the fee. Rather they collect the fee from users (state agencies and other political subdivisions) of the contracts, recap the fee and remit to central procurement. Changing the fee during the term of the contract would require a price increase for goods and services, creating an administrative burden and increasing the cost of business for the vendor. Better to change the fee as new contracts are established and current contracts are renewed. This allows the vendor community to become aware of the new fee, as stated in each solicitation for goods and services, and to incorporate the amount of the fee into their quoted price. A state wide contract generally has a term of one to five years. The dollar value of the contracts varies. Instead of setting an annual benchmark for fee growth and appropriation reduction, the migration can be better managed by reducing subsequent year appropriation amounts by the same amount of administrative fee growth. The establishment of good contracts, used in sufficient volume by state agencies and other political subdivisions, will drive the growth of fees reducing and eventually eliminating the need for the annual appropriation. By setting a maximum carry forward, establishing expenditure authority through the Appropriations Act, and returning surplus cash to the general fund each year, the budget for the central procurement office will remain manageable and no larger than allowed by the General Assembly.

Evaluation Method

MMO will monitor the impact of this change by:
• Tracking the usage and volume of fees collected on new commodity statewide term contracts. The utility of the contracts can be determined by the amount of fees collected from the vendors. Fee volume is an indicator of the amount of sales vendors experience on their contracts. A contract generating fees is one used by the customers. The customers pay the fee, but take advantage of the savings the contract offers and the ease by which it allows the customer to stay in compliance with the South Carolina Consolidated Procurement Code. The volume of contract usage can be estimated using the in-house contract reporting system and contract usage information provided by the South Carolina Enterprise Information System. The in-house contract reporting system provides a method of estimating spend on statewide term contracts by non-SCEIS state agencies and other political subdivisions.

• Monitoring the collection of fees so that the program does not become too successful at generating revenue. Beyond that which is needed to adequately fund the Division, through good years and bad, some mechanism should be identified by which excess fees collected can be returned to the General Fund.

Summary and Recommendation

Of the states that participated in the NASPO 2009 Survey of State Government Purchasing Practices, 59% generate revenue used to fund all or part of the operation of their central procurement offices. The most common reported method used to
generate revenue is a fee on purchases made from statewide contracts provided by those offices.

Due to declining state appropriations, the Materials Management Office has found it problematic to adequately fund itself through a mix of appropriations and other revenue. Other revenue is primarily from administrative fees on statewide term contracts. A workable solution is for MMO to migrate to the self-funding method for generating revenue and become self-sustaining. To accomplish this MMO will need to increase the number of statewide term contracts available to state agencies and other political subdivisions in South Carolina and increase the fee on current contracts.

Increasing fees to support the self funding method will likely draw criticism from customers and concern from other stakeholders, notably the General Assembly. MMO will need to be prepared to provide information on the value its services give customers and stakeholders and that the change does not include an overall increase in cost to the State of South Carolina.
Appendix A

CHAPTER 11.

STATE BUDGET AND CONTROL BOARD

ARTICLE 1.

GENERAL PROVISIONS

SECTION 1-11-335. Budget and Control Board may provide to and receive from other governmental entities goods and services.

The respective divisions of the Budget and Control Board are authorized to provide to and receive from other governmental entities, including other divisions and state and local agencies and departments, goods and services, as will in its opinion promote efficient and economical operations. The divisions may charge and pay the entities for the goods and services, the revenue from which shall be deposited in the state treasury in a special account and expended only for the costs of providing the goods and services, and such funds may be retained and expended for the same purposes.

CHAPTER 35.

SOUTH CAROLINA CONSOLIDATED PROCUREMENT CODE

ARTICLE 1.

GENERAL PROVISIONS

SECTION 11-35-4860. Supply of personnel, information, and technical services.

(1) Supply of Personnel. Any public procurement unit is authorized, in its discretion, upon written request from another public procurement unit or external procurement activity, to provide personnel services to the requesting public procurement unit or external procurement activity with or without pay by the recipient governmental unit as may be agreed upon by the parties involved.

(2) Supply of Services. The informational, technical, and other services of any public procurement unit may be made available to any other public procurement unit or external procurement activity provided, that the requirements of the public procurement unit tendering the services shall have precedence over the requesting public procurement unit or external procurement activity. The payment shall be in accordance with an agreement between the parties.
(3) State Information Services. Upon request, the chief procurement officers may make available to public procurement units or external procurement activities the following services among others:

(a) standard forms;
(b) printed manuals;
(c) product specifications and standards;
(d) quality assurance testing services and methods;
(e) qualified product lists;
(f) source information;
(g) common use commodities listings;
(h) supplier prequalification information;
(i) supplier performance ratings;
(j) debarred and suspended bidders lists;
(k) forms for invitations for bids, requests for proposals, instruction to bidders, general contract provisions and other contract forms;
(l) contracts or published summaries thereof, including price and time of delivery information.

(4) State Technical Services. The State, through the chief procurement officers, may provide the following technical services among others:

(a) development of products specifications;
(b) development of quality assurance test methods, including receiving, inspection, and acceptance procedures;
(c) use of product testing and inspection facilities;
(d) use of personnel training programs.

(5) Fees. The chief procurement officers may enter into contractual arrangements and publish a schedule of fees for the services provided under subsections (3) and (4) of this section.
**EXECUTIVE SUMMARY**

<table>
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<tr>
<th>What We do</th>
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<tr>
<td>• Provide for the protection of life and property by insuring that state buildings are constructed in accordance with life, safety, and property protection codes. Section 10-1-180 &amp; 11-35-835 &amp; 6-9-110</td>
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<td>• Establish statewide contracts that lower prices by leveraging the collective needs of all state agencies and political subdivisions to gain greater volume discounts. Title 11, Chapter 35</td>
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<td>• Providing professional, centralized purchasing services to acquire all manner of supplies, equipment, services, information technology, and construction for almost every state agency for contracts. [During FY 2009, awarded contracts valued in excess of $2.5 billion.] Title 11, Chapter 35</td>
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<td>• Provides all staff for the state's Emergency Management Division for emergency disaster recovery procurements (hurricanes, terrorism, etc.) by acquiring supplies, services, and facilities damage assessments. Title 11, Chapter 35</td>
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<td>• Insure transparency and integrity in the expenditure of public money by auditing the internal procurement processes and expenditures of state agencies. Title 11, Chapter 35</td>
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SUMMARY OF COST AVOIDANCE GENERATED FOR AGENCIES BY THE DIVISION

- Creative savings idea
  - OSE presented an alternative solution to a water pressure problem at South Carolina State University with resultant cost avoidance/savings of $3.65 million

- Negotiated savings
  - SPO Pre-award and “in contract” negotiated savings $8,502,696
  - ITMO Pre-award and “in contract” negotiated savings $17,419,991

- NASPO benchmark savings
  - SPO
  - ITMO
  - Savings to state agencies generated by SCBO $1,547,590
  - Total Savings/Cost Avoidance generated by the Division $77,718,603

FY 2009-10 Budget $5.1 million
Division-wide Return on Investment (ROI): $15.24 for every dollar spent

($77,718,603 ÷ $5,100,000 = $15.24)

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4 Cost negotiations after determination of award.
5 National standard adopted by the National Association of State Procurement Officers in 2007
6 Cost to run SCBO ads in The State Newspaper minus SCBO expenses.
Division of Procurement Services

- Through a cross-divisional committee, and in cooperation with the Energy Office, Departments of Health & Environmental Control and Commerce, published in October 2009 an Environmentally Preferred Purchasing Policy. The policy is designed to, among other things; integrate environmental considerations into South Carolina government's procurement processes.

- This policy was recognized in June 2010 by Senate Bill 1497 “Encouraging Statewide Adoption of Green Purchasing Initiative Policies.”

- Provided procurement training to nearly 4,500 government employees and businesses during the fiscal year.

- Through a cross-divisional committee and in cooperation with Information Services, continued an initiative to consolidate the Division's three websites into one with the intent to roll-out in FY 2010-11. The goal of this consolidation is to promote better access to critical information for our customers and stakeholders.
Office of the State Engineer (OSE)

• OSE plan reviews resulted in significant savings to an agency. For instance, South Carolina State University (SCSU) was experiencing significant water pressure issues negatively affecting its ability to supply potable water for ordinary use and for fire suppression purposes. SCSU's engineer and the City of Orangeburg recommended a $4 million water tower as a solution to this problem. However, OSE staff reviewed plans of the city's water system and suggested an alternative that cost only $350,000 saving SCSU $3.65 million.

• Training Program
  • OSE developed a training program that provides for certification for construction procurement. The program will be launched in early FY 2011

• Procurement
  • OSE provided services to 45 agencies for 123 new Permanent Improvement Projects valued at $81,247,448.
  • OSE approved awards of contracts as follows:
    o A/E contracts 477 $33.6 million
    o Construction contracts 302 $245.6 million
    o Change orders 399 $19.2 million
  • OSE completed reviews/approvals of agency procurement actions within the 10 day standard 97% of the time.

• Building Codes and Life Safety
  • OSE issued building permits for 38 projects and certificates of occupancy for 54 projects
  • OSE completed review/approval of design documents within the 45 day standard 99.9% of the time

• Process Improvement
  • OSE published for comment revisions to the Manual for Planning and Execution of State Permanent Improvements – Part II, which will implement recommendations of the OSE focus group (made up of representatives from OSE, agencies, SC Chapter of the American Institute of Architects, SC Council of Consulting Engineers, SC Associated General Contractors, and SC Mechanical Contractors Association).
  • OSE has been working with legal council to develop modifications to the latest edition of American Institute of Architect Standard Contract Documents adopted
by regulation and has completed modifications to three of four documents. OSE has published the completed modifications for comment.
State Procurement Office (SPO)

- SPO returned $7.54 dollars for every dollar of operating expense. SPO’s operating expenses for FY 09 – 10 was $1,127,260.00
  After the receipt of competitive bids, SPO negotiated additional savings of $8,502,696.
  \[ \frac{8,502,696}{1,127,260} = 7.54 \]

- As measured by NASPO, SPO generated over $20 million dollars in savings.

- SPO awarded 140 contract categories totaling approximately $950 million dollars.

- SPO maintains 78 state term contract categories and over 2,000 individual contracts. Government agencies purchased more than $240 million dollars worth of goods and services from these contracts.

- Awarded contracts for recycled products totaling $1.3 million.

- The Procurement Card contract administered by SPO generated revenue to the State in the form of improved rebate totaling $3,100,000. Of this $3.1 million, rebates to the General Fund were approximately $1,400,000, agency rebates were $1,000,000 and local government rebates were $300,000. The spend volume was $241,244,929.

- (FY 09 data) Generating credits to agencies for pharmaceuticals - As a benefit of South Carolina’s participation in the Minnesota Multi-State Contracting Alliance for Pharmacy (MMCAP), South Carolina governmental agencies received facility credits in the amount of $162,000+ during 2008-2009 with a total sales volume of $48,744,300. Note: 2009-2010 facility credit and sales totals will not be available until February 2011.

- Coordinated with the Office of the Comptroller General to re-write the Procurement Card Policy and Procedure Manual for use by governmental customers in South Carolina. This new manual publishes strict controls for card programs across the state to enhance accountability and efficiency.

- In cooperation with the Energy Office, SPO established a contract for the Energy Star Appliance Rebate Program, a federal program that resulted in $3.9 million in rebates to residential customers for the purchase of energy efficient appliances. The program began March 31, 2010, and continued until all funds were exhausted May 19, 2010.

- In cooperation with the Department of Environmental Control, SPO established a contract for the Women, Infants and Children (WIC) Program Infant formula Rebate Program, a federal program with the potential to result in over $34 million in rebates to eligible participants. The program provides specific nutritious foods in quantities tailored to meet the needs of low income participants.
Information Technology Management Office (ITMO)

- ITMO returned $14.02 dollars for every dollar of operating expense. ITMO's operating expenses for FY 09 - 10 was $1,242,589.00. After the receipt of competitive bids, ITMO negotiated additional savings of $17,419,991.83. ($17,419,991.83 ÷ $1,242,589.00 = $14.02)
- As measured by NASPO, ITMO generated over $26 million dollars in savings.
- ITMO awarded 64 contract categories totaling approximately $310 million dollars.
- ITMO maintains 67 state term contract categories and over 1,000 individual contracts. Government agencies purchased more than $428 million dollars worth of goods and services from these contracts.
- In administering these contracts, ITMO issued 229 contract change orders covering product changes and price decreases of over $5,179,000.00.
- ITMO has negotiated 32 statewide software license agreements providing a single set of licensing terms and conditions for all governmental entities.
- ITMO maintains a statewide hardware leasing contract providing a single set of terms and conditions for all technology leases.
- ITMO's hardware maintenance manager contract saved $130,212.55 over previous year's maintenance contracts and returned an additional $16,970.88 in profit sharing to state agencies.
- ITMO's electronic recycling contract returned $5,000 to state agencies for recycling hard drives.
Audit & Certification

- Audit & Certification completed audits of 15 agencies and also have 5 in work in process for the fiscal year ending 6/30/10.

- 10 agencies were audited for higher procurement certification, 7 were non-certified audits, one was a statutory requirement, completed one school district audit (11-35-70) and performed an interim review at another school district at the district’s request.

- Audit and Certification identified through audits $22,319,006 in illegal procurements this past fiscal year. Actions taken against the worst offenders resulted in reduction of procurement authority at the South Carolina Commission for the Blind and refusal to recommend increased procurement authority to the Budget and Control Board for the Medical University of South Carolina.

- After performing an audit of a State contract vendor, we initiated a contract controversy against the vendor for violating its contract with the State and recommended a refund to the State of more than $7.2 million.

- Our audits revealed abuses by agencies that utilize Indefinite Delivery Contracts (IDC) where hundreds of thousands of dollars in construction work orders were being awarded with no competition, among other findings. We recommended revised procedures that brought about tighter controls.
Program Support

Training Support/Accounts Receivable/Web site maintenance

- Administered support activities related to procurement training classes. Includes registration, billing for registration fees, reconciliation of accounts receivable for registration billing. Provided support to instructor(s) during training classes. Processed invoices for all billable services performed by the Division.

- Posted all contract changes and new Statewide Term Contracts to Division website for the State Procurement Office.

Vendor Registration

- Reviewed all vendor registrations for correctness and reduction of duplication in vendor master files. Provided customer service to vendors with questions on vendor registration process. Provided assistance to SCEIS Helpdesk on matters related to vendor registration.

Contract Activity Tracking and Reporting

- Administered contract activity reporting on state wide term contracts issued by the Division of Procurement Services. Worked to insure contract reporting is accurate.

South Carolina Business Opportunities

- Published the South Carolina Business Opportunities (SCBO) each Monday and Thursday throughout the year to provide the business community ready access to state business.

- Generated savings to state agencies through publication of bid advertisements in the South Carolina Business Opportunities (SCBO) $1,547,590 (Cost to run SCBO ads in The State Newspaper minus SCBO expenses.

Training Development

- Worked cooperatively with other sections within the Division to develop and implement a procurement training curriculum for professionals seeking procurement certification in the State of SC.