

OFFICE OF THE CITY CONTROLLER



**ADMINISTRATION AND REGULATORY AFFAIRS DEPARTMENT
(ARA) – STRATEGIC PURCHASING DIVISION (SPD)**

**CONTRACT COMPLIANCE AND PERFORMANCE AUDIT
C#61899**

OFFICE SUPPLIES VENDOR – OFFICE DEPOT, INC.

Ronald C. Green, City Controller

David A. Schroeder, City Auditor

Report No. 2013-03



OFFICE OF THE CITY CONTROLLER
CITY OF HOUSTON
TEXAS

RONALD C. GREEN

December 7, 2012

The Honorable Annise D. Parker, Mayor
City of Houston, Texas

**SUBJECT: REPORT #2013-03
ARA/SPD – CONTRACT COMPLIANCE AND PERFORMANCE AUDIT OF
#C61899 – INTERGOVERNMENTAL AGREEMENT – OFFICE DEPOT (OD)**

Dear Mayor Parker:

I am submitting to you Audit Report #2013-03 which details the results of our contract compliance and performance audit related to City contract #C61899. The audit process was challenging based on the protective and defensive posture of the vendor. The notification letter was sent to the Vendor on November 7, 2011. Early on in the audit, all communications, including audit requests, technical questions, etc. were directed to Office Depot's outside counsel in charge of settlements for claims related to overcharges (Williams and Connolly LLP). As you are aware, Office Depot has settled claims with other jurisdictions and is under investigation and engaged in litigation with yet others.

The primary audit objectives were:

1. Determine if OD has charged the City for office supplies according to agreement terms and
2. Determine compliance with other key terms of the agreement.

Based on the lack of cooperation by the vendor to provide some of the information we requested per the contract terms and the delays in their responses, along with the discrepancies, anomalies, and inconsistencies in the data provided, we developed alternative procedures based on professional auditing standards along with discussions with other governmental agencies that have performed audit(s) on Office Depot. This resulted in designing three different methods for calculating compliance with pricing terms and related overcharges. Each method resulted in significant overcharges by the Vendor.

NOTE: The results of our substantive testing were based on the data that the Vendor provided. This was represented by 299,914 transaction lines that totaled \$19,182,251.83.

There were three primary findings/issues as follows:

- **Overcharges** to the City for office products purchased of **\$1,722,333.91 – \$6,599,907.75**;
- **Data Anomalies and Inconsistencies** – **\$5,716,877** purchases did not have corresponding price list for the COH, of which **\$2,315,995** could not be validated without using alternative price lists from other jurisdictions; and
- **Non-Compliance with Required Information Requests** – Vendor refused to provide some financial information required to validate the discount calculations, transfer pricing, cost and didn't provide fully executed contract amendments which included agreed changes to core item prices.



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The Vendor disagrees with the results of the audit and we have included those responses as Exhibit 2 in the report, along with the Audit Division's Assessment of Vendor Responses identified as Exhibit 3.

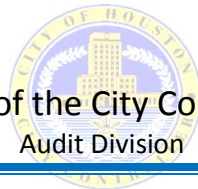
Respectfully submitted,

Ronald C. Green
City Controller

cc: City Council Members;
Alfred Moran, Director, Administration and Regulatory Affairs Department
Chris Brown, Chief Deputy City Controller;
Waynette Chan, Chief of Staff, Mayor's Office;
Andy Icken, Chief Development Officer, Mayor's Office;
David Schroeder, City Auditor

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EXECUTIVE SUMMARY

INTRODUCTION –

The City of Houston (COH) Office of the City Controller, Audit Division has completed a Performance Audit and Contract Compliance of COH Intergovernmental Agreement (IGA) (Contract #C61899), signed and executed by COH, Office Depot Incorporated (VENDOR), and Los Angeles County (COUNTY). The Contract was administered by Administration and Regulatory Affairs Department's (ARA) Strategic Purchasing Division (SPD). The Intergovernmental Agreement inherited all rights and obligations of the Master Agreement (MA) #42595 between COUNTY and VENDOR (except as otherwise modified or excluded). The MA was predicated on an Administrative Agreement (AA) between VENDOR and U.S. Communities (USC), which is a government purchasing cooperative acting as an agent on behalf of its membership (COH is a member of USC. Therefore the Administrative Agreement set the tone for the contractual relationships between the VENDOR and public agencies (in or outside of the USC agreement).

BACKGROUND –

COH Contract #C61899 was effective from March 6, 2006, through December 31, 2010. The original Request for Council Action (RCA) was presented and passed as Ordinance 2006-0246. Using the data provided by Office Depot (OD), the COH purchased \$19,182,252 of supplies and other goods during the contract period.

KEY TERMS

- **Lead Agency** is the governmental entity that negotiates the primary contract (Master Agreement) with the VENDOR, setting terms and conditions for other state and public agencies to inherit. The required procurement process is performed by the Lead Agency so that Participating Agencies do not have to replicate.
- **Agent** is the entity that represents the cooperative group of participants or members. In this case the membership consisted of governmental entities registered with USC, who then act as the agent on their behalf.
- **Participating Agency** are the governmental entities or customers that engage in the Master Agreement through an intergovernmental agreement with the Lead Agency
- **Master Agreement (MA)** is a contract for specific product and/or services as negotiated between the Lead Agency and the VENDOR. The MA can be linked to other governmental relationships (Participating Agencies) via an intergovernmental agreement with each Participating Agency.
- **Administrative Agreement (AA)** is a contract between the VENDOR and the Agent acting on behalf of a collective group. In this case a membership of governmental entities was represented by an entity called U.S. Communities (USC). The AA must be in place prior to the MA being executed. The AA sets commitments, terms, conditions, and consideration (fee arrangement) between the VENDOR, Lead Agency, all Participating Agencies, the Agent and ANY other government entity that is not part of the cooperative group.
- **Intergovernmental Agreement (IA)** is the contract vehicle by which governmental entities become Participating Agencies. The agreement is between the Participating Agency, the Lead Agency, and VENDOR. The IA inherits or "piggy-backs" off of the MA.
- **SKU** is the VENDOR's unique product identification number that is correlated with item classifications (Core, Non-Core, etc.)



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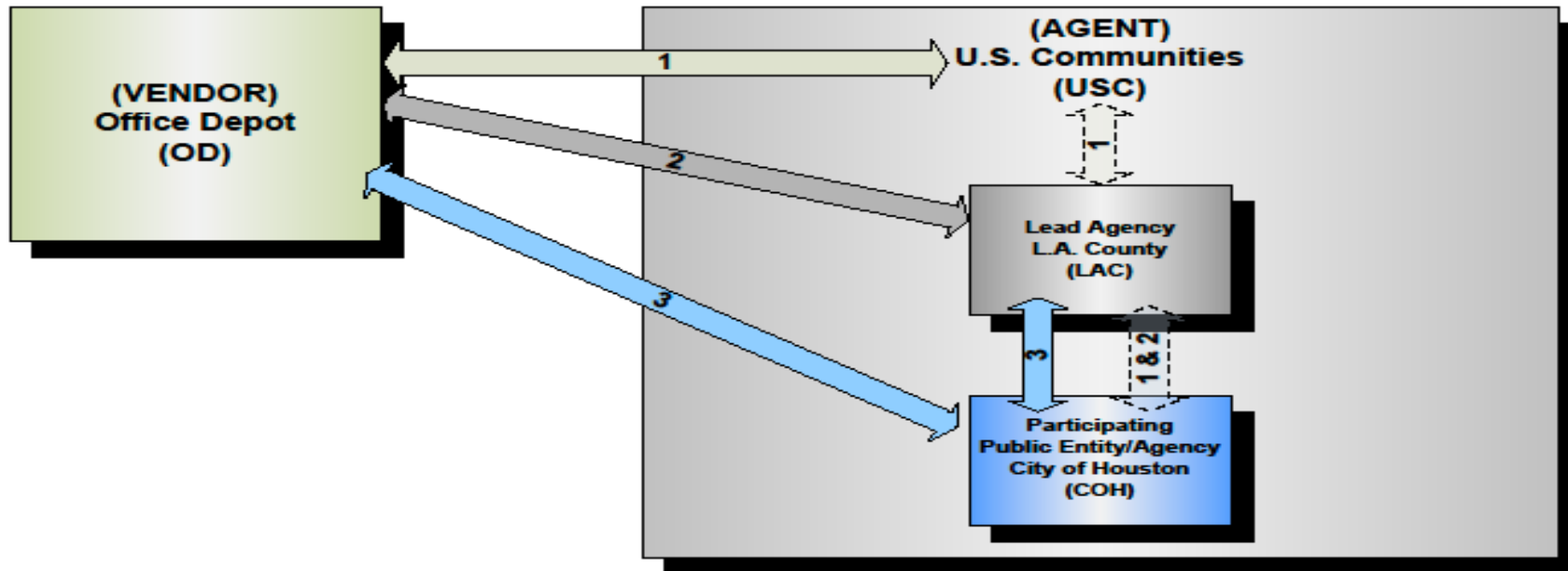
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- **Core** items are a classification of products that have negotiated prices, subject to change only by Contract Amendment(s) as executed by the VENDOR and Lead Agency. The Lead Agency had the responsibility to retain and communicate ALL contract amendments to ALL Participating Agencies.
- **Non-Core** items are generally subject to discount methodology depending on type. The Undiscounted List Price (LL) is reduced by a percentage discount, subject to a gross profit floor (GP Floor). According to the MA, these items could be changed twice a year, subject to review by the Lead Agency. The MA also directed the VENDOR with the responsibility to communicate ALL price changes to ALL Participating Agencies. The primary discount formulas during the contract period were:
 - ✓ (LL – 70%) subject to a 15% GP Floor
 - ✓ (LL – 45%) subject to a 15% GP Floor
- **Non-Core/Non-Plan** is a classification of products that are not identified as either Core or Non-Core. They are not considered part of the primary discount pricing structure.¹
- **Customer Price Lists** are detailed lists of prices to be charged to the Lead Agency and Participating Agencies (Customers) for Core, Non-Core items, and any other items purchased from VENDOR. Every item purchased should have a related price specific to the Customers under the agreement.
- **Undiscounted (Manufacturer List) Prices** are gross (Undiscounted) Prices that are used as a basis for calculating the potential discount. Each item should have an Undiscounted List Price from which to recalculate and validate an accurate final (discounted) price charged to the customer.
- **GP Floor** is a guaranteed margin that limits the potential discount for the benefit and protection of the VENDOR (*on a line item basis*, due to fluctuations in market prices.) In order to validate these calculations, actual cost data needs to be verified through access to VENDOR's detailed procurement records.

¹ Based on the overall business goal, these generally represent a small portion of purchasing activity and are considered non-contract, typically subject to a 10% discount



DIAGRAM 1: Contractual and Legal Relationships



1 – Administration Agreement (AA) (Executed 11/08/2005) serves as a satellite agreement that allows participation in the USC cooperative arrangement by embedding responsibilities and rights to all contracts engaged with agencies/entities (Lead and otherwise). The AA between OD and USC includes a guarantee of lowest prices nationwide and also prohibits OD from selling like goods to state and local agencies outside of the Lead contract at lower prices. **NOTE: If lower prices are negotiated, they have to be done so through the Master Agreement (MA), thus lowering the prices to all agencies riding on the MA (Attachment H).**

2 – Master Agreement (MA) #42595 (Executed 01/02/2006) serves as the basis for the Lead Agency (LAC) to engage in procurement of goods and/or services with negotiated terms for the benefit of USC members (which includes LAC and all Participating Public Agencies, in this case COH). The fundamental purpose of the agreement is to outline a listing of goods to be purchased at agreed pricing and terms, changes to prices, audit rights, etc. This sets a relationship to all participating agencies providing the same prices as in the MA and extends the pricing guarantee as committed to in the AA. This also includes a responsibility by OD to provide "all financial information..including proprietary..." for the purpose of payments to USC and supporting consistent prices charged to all entities engaged with OD.

3 – Intergovernmental Agreement (IA) #C61899 (Executed 03/06/2006) inherited pricing terms and all related elements to support approved changes, pricing guarantees, etc. It further explicitly modified specific sections of the MA, one of which was an audit clause specific to the City of Houston.



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The AA and the MA, (and thus the IGA) gave certain guarantees to ensure lowest pricing. First, the Administrative Agreement between USC and Office Depot set guidelines for Office Depot to be a supplier through the USC contract. Specifically, Office Depot was to apply the following guidelines in responding with potential bids to government entities/agencies who were not members of USC.

U.S. COMMUNITIES ADMINISTRATION AGREEMENT, ATTACHMENT H, PAGE 5

“PUBLIC AGENCY SOLICITATION RESPONSE GUIDELINES

While it is the objective of the U.S. Communities program to have public agencies piggyback on the contracts rather than issue their own bids and RFPs, U.S. Communities recognizes that for various reasons many public agencies will issue their own solicitations. The following options are available to U.S. Communities Suppliers when responding to Public Agency solicitations.

1. **Respond to the bid or RFP with pricing that is higher** (net to buyer) than the Suppliers' U.S. Communities contract pricing.
2. Respond to the bid or RFP with pricing that is higher (net to buyer) than the Suppliers U.S. Communities contract pricing. If an alternative response is permitted offer the U.S. Communities contract as an alternative for their consideration.
3. **Respond with your U.S. Communities contract pricing**: If successful the sales would be reported under U.S. Communities,
4. **If competitive conditions required pricing lower than the standard U.S. Communities contract pricing, the supplier can submit lower pricing through the U.S. Communities contract. If successful the sales would be reported under U.S. Communities,**
5. **Do not respond to the bid or RFP.** Make the U.S. Communities contract available to the agency to compare against their solicitation responses.”

NOTE: #4 above supports using other public entities as comparison even if they are not a PA, not a member of USC, nor a party to the Master Agreement.

AUDIT SCOPE AND OBJECTIVES –

As communicated in the Notification Letter issued to Office Depot on November 7, 2011, the initial Audit Objectives were as follows:

1. Determine if Office Depot (OD) has charged COH for office supplies according to agreement terms and
2. Determine compliance with other key terms of the agreement(s).

The primary auditee of this project was OD, while the contract owner of the Intergovernmental Agreement was COH as managed by SPD within ARA. Therefore, we focused primarily on Audit Objectives outlined above as they pertain to the VENDOR, while also being cognizant of contract management as performed by SPD and the relationship of the parties to the original agreement (VENDOR, Lead Agency, and Agent). Any issues identified associated with ARA/SPD or other COH internal controls, are reported separately. As information/evidence was gathered and analyzed, modifications to our scope, objectives and procedures occurred. (See **SCOPE MODIFICATION** Section, **SUMMARY CONCLUSION 2**, and **Finding #3**) The period of activity used for our scope was the entire contract term. (From March 6, 2006 to December 31, 2010)

SCOPE MODIFICATION –

The MA, which was adopted by the IA defined commitments, identified communication protocol, and set requirements for the VENDOR. This included access to information in order to support the audit rights stated in the agreements. (See MA 42595, Section 8) The VENDOR did not provide several items from our data requests which were required to substantiate stated contract pricing elements. Additionally, there were several anomalies/inconsistencies with the data that was provided, including missing price list information, changing product classifications that reduced or eliminated the discount, which resulted in price increases.²

As a result, we modified our audit procedures by relying on and utilizing; (a) detail purchasing data that occurred during the contract period as provided by Office Depot, (b) comparative data from other governmental entities (Dallas County and the City and County of San Francisco), and (c) key representations of the VENDOR in their proposal/bid (See excerpt below). Because actual purchase data was not available from either of these jurisdictions, we used the price lists provided.³ Our assumption was that the Price Lists should represent what the respective jurisdiction was to pay, thus Price List should equal Purchase Price (this is the premise to validate contract compliance). We utilized alternative procedures by calculating three different comparisons. (1) Net to Buyer Method; (2) Recalculated Discount Method; and (3) Lowest Price Comparison.⁴ (For detailed explanation of each calculation, see **Finding #1**.)

NOTE: Dallas County was a member of USD and thus was a PA to the Master Agreement, while the City and County of San Francisco was not, but had a separate contract, subject to AA conditions.

“MASTER AGREEMENT BETWEEN COUNTY OF LOS ANGELES AND OFFICE DEPOT FOR OFFICE AND CLASSROOM SUPPLIES

EXHIBIT “A”

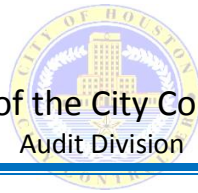
Tab 3 - Attachment E, 4.0 Office Depot Business Proposal,

*"The pricing information included in Attachments A and C reflects a discount from Manufacturer Suggested List Pricing with an accompanying minimum Gross Profit Percentage Floor according to the bid specification categories as outlined, i.e. (General Office and Stationery Supplies, Toner Items, Furniture, Technology Items and Paper Products) the discounts cover all items in our BSD Catalog. The Pricing is stated in this format: Office Depot will quote a discount from list price structure for the custom Everyday Office Essentials (EOE) catalog, a 4,000+ item subset of the over 14,000 item BSD Catalog. **This catalog is currently in use at County of Los Angeles and at existing Participating Public Agencies utilizing the National Office Depot – US Communities program. This discount from list will blanket cover all items in the EOE catalog regardless of the product category. The over 4,000 item EOE catalog is representative of over 70% of the total spend in the existing Office Depot – US Communities program. The pricing stated for the EOE catalog is LL70% w/15% GP Floor (LL stands for Mfg. List Price Less).In addition, the remainder of the BSD 12 Catalog (over 10,000 items) is priced at LL45% w/15% GP Floor with the exception of Special Products or Items shipped directly from the Manufacturer. Special products or items shipped directly from the Manufacturer are noted in our catalog with an S or M. Pricing for these items will be LL10%**"*

² See Data Analysis Section in the Detailed Report and Generally Accepted Government Auditing Standards, § 6.39

³ Generally Accepted Government Auditing Standards § 6.38 – 6.40; 6.56 – 6.72

⁴ The discounts apply primarily to items that are not “Core”



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PROCEDURES PERFORMED –

We utilized detailed transaction data provided by Office Depot as the basis of our substantive testwork. Also, in order to achieve the Audit Objectives and support our findings and conclusions we requested/performed the following:

- Reviewed and summarized relevant agreements that support the relationship and procurement activity;
• Requested all critical documentation needed to validate pricing terms and commitments contained in the contract and performed relevant procedures on all information provided;
• Verified and validated the data provided for completeness, accuracy and reliability;
• Compared COH purchases activity to three governmental entities Customer Price Lists for accuracy and consistency with contract terms.
• Recalculated the expected discounts as proposed by the VENDOR and included in the MA.

AUDIT METHODOLOGY –

The audit was performed in accordance with Generally Accepted Government Auditing Standards as promulgated by the Government Accountability Office (GAO) and was conducted in conformance with the International Standards for the Professional Practice of Internal Auditing as issued by the Institute of Internal Auditors (IIA). Those standards require that we plan and perform the audit to obtain sufficient and appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. By stating “in accordance” and “conformance” we are communicating that we have met the threshold for the assurance and conclusions rendered in this report.

SUMMARY CONCLUSIONS AND SIGNIFICANT ISSUES –

SUMMARY CONCLUSION 1 (Audit Objective #1, See Finding #1)

Based on the SCOPE MODIFICATION, which included incomplete and missing data from the VENDOR, we designed three methods for testing the accuracy of purchases and the likely overcharges. The results of the procedures performed, showed that the VENDOR overcharged the City of Houston no less than \$1,722,333.91 and up to \$6,599,907.75 (Audit Objective #1) for purchases that took place between March 6, 2006 and December 31, 2010. (For calculation details and support, See Finding #1).5

Table with 2 columns: Method and Overcharge amount. Rows include Dallas County, City and County of San Francisco, RE-CALCULATED DISCOUNT METHOD, and LOWEST PRICE COMPARISON.

5 (1) Net-to-Buyer and the (2) Re-Calculated Discount methods were added to the report as part of addressing management responses. The principles of these methodologies were in an earlier draft, however the latest presentation to the vendor was the most conservative (lowest overcharge) approach.

SUMMARY CONCLUSION 2 (*Audit Objective #2*) – (See **SCOPE MODIFICATION** Section of the **EXECUTIVE SUMMARY** and **Finding #3**)

Based on the results of the procedures performed, the **VENDOR** was not compliant with other key contract terms. Several items required to be provided to Participating Agencies throughout the contract period were not provided, including, but not limited to:

- Detail Cost Information supported by **VENDOR** purchasing activity;
- All Audit Reports performed on the **VENDOR** (primarily those that are relevant to the agreements or similar agreements); and
- Manufacturer identification.

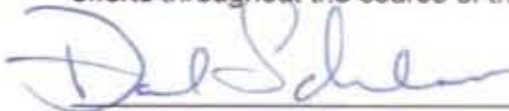
This prohibited the COH from verifying the accuracy of the Customer Price Lists for all **\$19,182,252** of COH purchases for the contract term.

In addition to the items listed above, several other required contract items were requested, but not provided, such as:

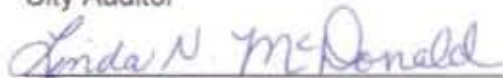
- Executed Contract Amendments that may have changed prices to Core Items;
- Semi-Annual price list changes for Non-Core Items; and
- Support for changes of product classifications (from Core to Non-Core, etc.).

ACKNOWLEDGEMENTS AND SIGNATURES –

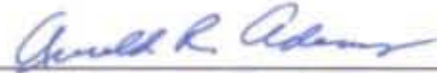
The Audit Team would like to thank ARA/SPD management for their cooperation, time, and efforts throughout the course of the engagement.



David Schroeder, CPA, CISA
City Auditor



Linda N. McDonald, CPA, CIA
Assistant City Auditor IV



Arnold R. Adams, CIA, CFE
Assistant City Auditor V



DETAILED REPORT

DATA VALIDATION AND ANALYSIS – (ANOMALIES AND INCONSISTENCIES)

We first analyzed the population of transactional data (obtained from OD) by summarizing according to SKU classification/category of product related to Customer Price lists pertaining to COH.

This analysis identified the following:

- 299,914 lines of transactional data occurred between March 6, 2006 through December 31, 2010 (this included credits, returns, adjustments, etc.), which resulted in net charges of \$19,182,252.
- The purchases involved 24,170 different SKUs,

We then matched the transactions to the CPL provided by category, which identified four different classifications/trends of purchasing by SKU categories as shown in CHART 1.

CHART 1 SUMMARIZED PURCHASING BY SKU CLASSIFICATION				
Classification No.	Description of SKU Classification for Items Purchased	Quantity of SKU's	Quantity of Transactions	Amount Purchased/Paid by COH
1	Core Items	476	46,744	\$ 4,993,436
2	Non-Core Items	15,536	199,086	\$10,474,044
3	SKU Items that appeared on <i>both</i> Core and Non-Core COH Customer Price Lists	657	26,033	\$ 1,873,223
4	SKU items that didn't appear on any COH Customer Price Lists – No Customer Price History	7,501	28,051	\$ 1,841,549
Total		24,170	299,914	\$19,182,252

DATA ANOMALIES

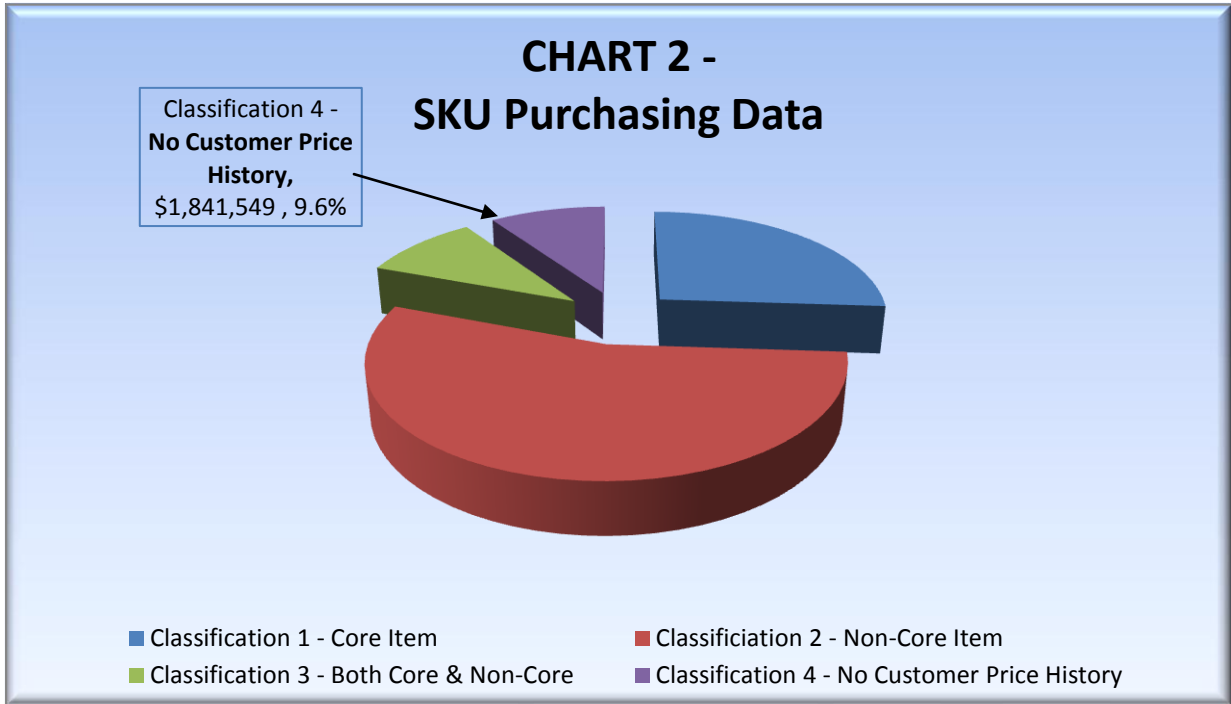
Reviewing Office Depot's data as stratified in CHART 1 identified the following data anomalies:

- CHART 1, Classification No. 4 reveals that 31% of the SKU volume (7,501 SKUs), 9% of the transaction volume (28,051) and 9% of the total amount paid by COH (**\$1,841,549**) was ***not identified with any classification and did not have a corresponding Customer Price List.*** For these items, there is no basis to calculate a discount without a price or classification to associate the item.⁶

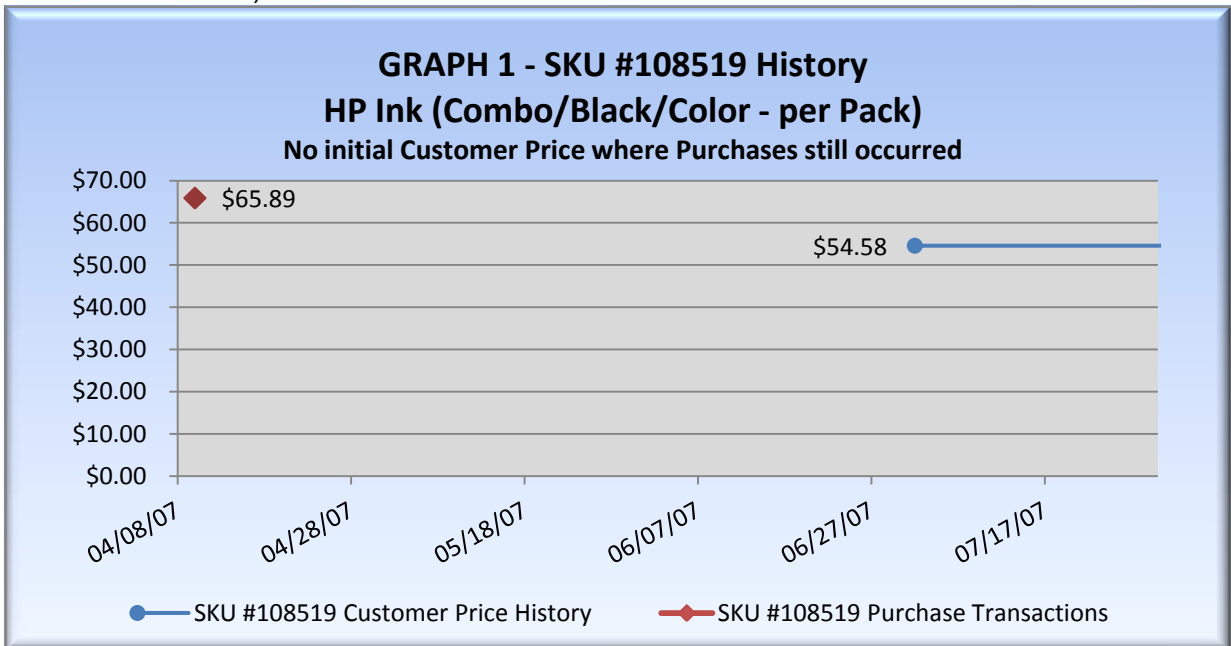
⁶ The VENDOR could not and/or would not provide information to validate the assertion that pricing and charges to COH were accurate. (See **CHART 3** and **Finding #3**)



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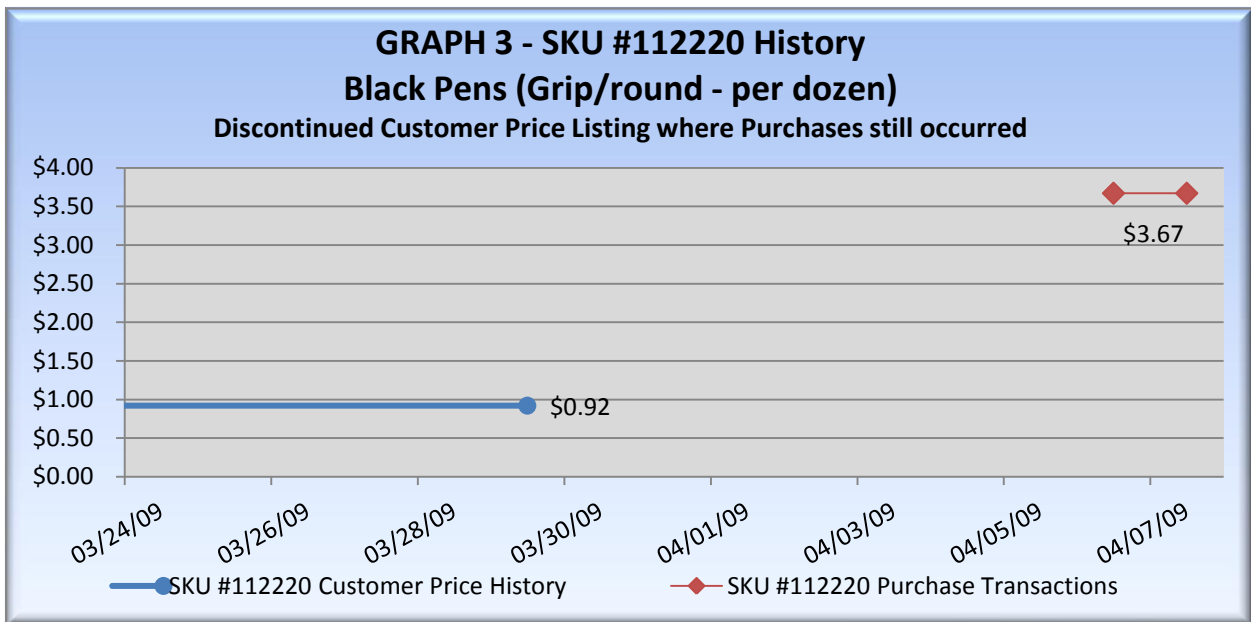
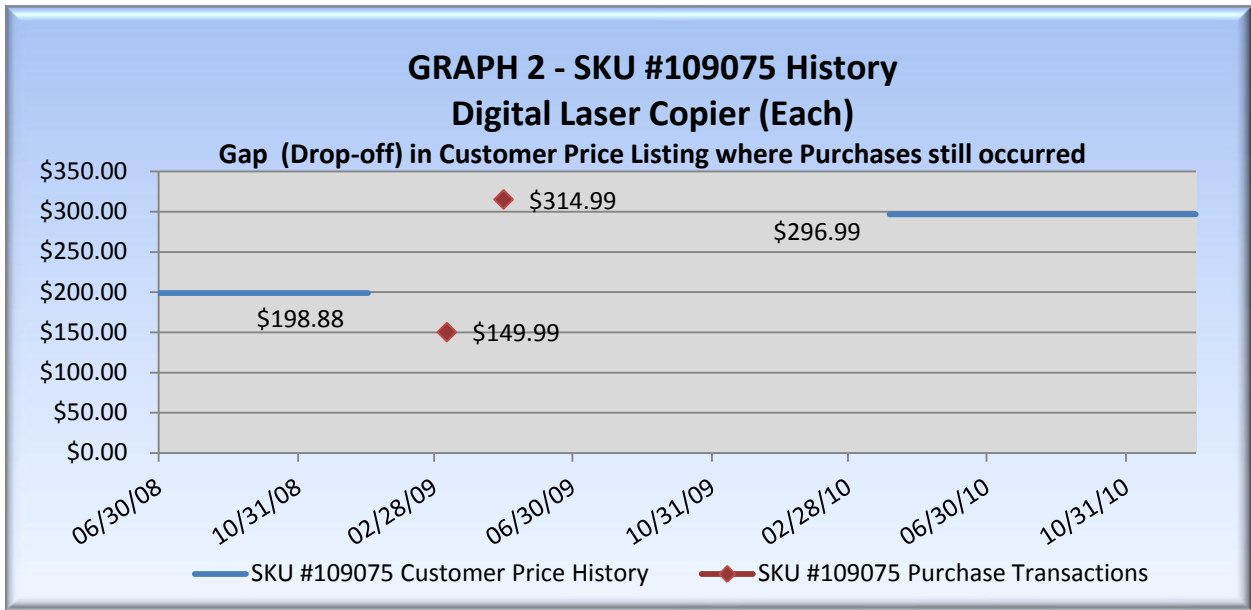


- Additionally, a *subset* of SKU Classification Numbers 1, 2 & 3 from Chart 1 (8,038 SKUs) had 33,105 transactions, representing an amount of **\$3,900,555** paid by COH that didn't have a Customer Price Listed at the time of the purchase, however they appeared on customer price lists at other points throughout the contract period. The VENDOR had no substantive reason to explain. (**Examples of Actual SKU Price Histories are presented in GRAPHS 1-3**)





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Therefore, prior to being able to compare the amount COH paid vs. the accurate price per the contract, Office Depot provided an initial data set representing 15,470 different SKUs, 61,156 transaction lines, totaling \$5,716,878 that had **No Customer Price List**. We therefore, developed alternative audit procedures and analysis as explained in the **SCOPE MODIFICATION** Section and the Detailed Findings.

Chart 1, Classification 4, shows **\$1,873,223** of the total purchases were classified as both “Core” or not “Core”, at some point throughout their history. One of the effects of this change is identified below in Chart 3.



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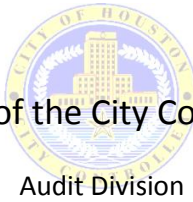
The classification type 3 identified in Chart 1 had instances where SKU's shifted back and forth between Core and Non-Core, which resulted in price increases not subject to contract amendment, thus bypassing the contract requirements.

Chart 3 – Impact of SKU Classification Changes

Order Date	Ship Date	Order Nbr	SKU Number	SKU Description	UOM	Quantity Ordered	SKU List Price	Unit Price	Extended Price	Pricing Option Used	Non-Core/Non-Price Plan
08/01/06	08/01/06	34706207	775088	PAD,EASEL,RESTICKABLE,TABLETOP	EA	1	\$24.99	\$7.50	\$7.50	Option 1	No
01/23/07	01/24/07	37271418	775088	PAD,EASEL,RESTICKABLE,TABLETOP	EA	20	\$24.99	\$7.50	\$150.00	Option 1	No
06/26/07	06/26/07	39181699	775088	PAD,EASEL,RESTICKABLE,TABLETOP	EA	1	\$24.99	\$7.50	\$7.50	Option 1	No
06/28/07	06/29/07	39220750	775088	PAD,EASEL,RESTICKABLE,TABLETOP	EA	2	\$24.99	\$7.50	\$15.00	Option 1	No
09/28/07	10/03/07	40338439	775088	PAD,EASEL,RESTICKABLE,TABLETOP	EA	6	\$24.99	\$7.50	\$45.00	Option 1	No
04/18/08	04/21/08	42758270	775088	PAD,EASEL,RESTICKABLE,TABLETOP	EA	1	\$34.99	\$31.49	\$31.49	Option 1	Yes
07/23/08	07/29/08	43775908	775088	PAD,EASEL,RESTICKABLE,TABLETOP	EA	3	\$34.99	\$30.99	\$92.97	Option 1	Yes
08/27/08	08/27/08	44200962	775088	PAD,EASEL,RESTICKABLE,TABLETOP	EA	3	\$34.99	\$30.99	\$92.97	Option 1	Yes
09/16/08	09/16/08	44433279	775088	PAD,EASEL,RESTICKABLE,TABLETOP	EA	3	\$34.99	\$7.50	\$22.50	Option 1	No
10/27/08	10/28/08	44931075	775088	PAD,EASEL,RESTICKABLE,TABLETOP	EA	3	\$30.99	\$30.99	\$92.97	Option 1	Yes
01/23/09	01/23/09	46153294	775088	PAD,EASEL,RESTICKABLE,TABLETOP	EA	3	\$30.99	\$30.99	\$92.97	Option 1	Yes
03/30/09	03/30/09	46952245	775088	PAD,EASEL,RESTICKABLE,TABLETOP	EA	2	\$30.99	\$30.99	\$61.98	Option 1	Yes
03/30/09	03/30/09	46952245	775088	PAD,EASEL,RESTICKABLE,TABLETOP	EA	3	\$30.99	\$30.99	\$92.97	Option 1	Yes
08/12/09	08/12/09	48440324	775088	PAD,EASEL,RESTICKABLE,TABLETOP	EA	4	\$30.99	\$30.99	\$123.96	Option 1	Yes
11/08/09	11/08/09	49714950	775088	PAD,EASEL,RESTICKABLE,TABLETOP	EA	1	\$30.99	\$30.99	\$30.99	Option 1	Yes
12/02/09	12/02/09	49972005	775088	PAD,EASEL,RESTICKABLE,TABLETOP	EA	4	\$30.99	\$30.99	\$123.96	Option 1	Yes
12/11/09	12/11/09	50110803	775088	PAD,EASEL,RESTICKABLE,TABLETOP	EA	4	\$30.99	\$30.99	\$123.96	Option 1	Yes

The initial pricing on this item was the Correct Pricing (List – 70%), which we did NOT note as an exception at during that period

The SKU 775088 bounced back and forth in its classification (Non-Core-NC/NP – Non-Core-NC/NP)
 Changing the classification in 2008, had the effect of changing the discount percentage/strategy and significantly increasing the unit price.
 At one point the discount is reduced to 10% and
 Then the discount is eliminated altogether.



FINDING #1 – OVERCHARGES FOR PRODUCTS PURCHASED

RISK RATING (IMPACT AND MAGNITUDE) = HIGH

BACKGROUND:

The primary Audit Objective was to verify that the COH paid agreed prices for products purchased from VENDOR throughout the contract term. In order to adequately perform audit procedures to obtain sufficient and appropriate evidence to render conclusions, we relied on the following:

- Detailed purchasing data provided by the VENDOR, for transactions occurring during the contract period. (from March 6, 2006 through December 31, 2010)
- Executed contract documents, agreements, amendments, exhibits and attachments, between COH, VENDOR, Lead Agency, and USC;
- COH customer price list as provided by the VENDOR;
- Customer Price Listings from two other governmental entities; and
- Representations made in the VENDOR'S proposal as incorporated into the MA

Because the Customer Price Lists (CPL) provided by the VENDOR were incomplete, and because the Administrative Agreement contained specific protocol for the VENDOR to engage in other contracts with governmental entities, the audit team obtained additional CPL's from other governmental entities/agencies.

Based on the Scope Limitation and the Data Anomalies identified in the Executive Summary, we developed and performed alternative procedures by calculating three different comparisons that determined the likely overcharges:

- (1) Net to Buyer Method;
- (2) Recalculated Discount Method; and
- (3) Lowest Price Comparison.⁷

Therefore, the CPL information used for the Net to Buyer Method and the Lowest Price Comparison Method came from the following sources:

- **Dallas County** – Participating Agency in the MA;
- **San Francisco** (City and County) – Governmental entity under contract with the VENDOR outside of the MA; and
- **COH/OD** – Customer Price Listings as provided to the audit team by the VENDOR for COH;

SUMMARY OF OVERCHARGES	
NET TO BUYER COMPARISON METHOD TO:	
Dallas County	Overcharge = \$1,722,333.91
City and County of San Francisco	Overcharge = \$6,599,907.75
RE-CALCULATED DISCOUNT METHOD	Overcharge = \$2,274,654 - \$3,216,984
LOWEST PRICE COMPARISON	Overcharge = \$3,045,739 - \$3,409,355

⁷ The discounts apply primarily to items that are not "Core"



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DETAILED FINDING RESULTS

(1) NET TO BUYER COMPARISON METHOD
AUDIT PROCEDURES –

- Matched purchase transactions, by SKU to price lists by effective dates for each of the two public agencies.
- Recalculated and compared the amount that would have been paid for each jurisdiction to the amount COH paid (in Total)
- Applied the results for each jurisdiction to the whole population

Table 1			
Net to Buyer Method			
Overall Spend Comparison to Dallas County			
	Based on Matched SKU's	Over-Charge %	Overcharge % Applied to the full COH spend
Net to Buyer Comparison to Dallas County			
<i>COH Paid</i>	\$ 2,643,080.64		
<i>Dallas would have Paid for the same items</i>	\$ 2,405,764.02		
Overcharge	\$ 237,316.62	9%	\$ 1,722,333.91

Table 2			
Net to Buyer Method			
Overall Spend Comparison to City and County of San Francisco			
	Based on Matched SKU's	Over-Charge %	Overcharge % Applied to the full COH spend
Net to Buyer Comparison to City and County of San Francisco			
<i>COH Paid</i>	6,021,999.61		
<i>San Francisco would have Paid for the same items</i>	3,950,051.01		
Overcharge	2,071,948.60	34%	6,599,907.75



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(2) RE-CALCULATED DISCOUNT METHOD (BASED ON VENDOR PROPOSAL)
(CONTRACT EXHIBIT "A" , TAB 3 – ATTACHMENT E, 4.0 OFFICE DEPOT BUSINESS PROPOSAL)

AUDIT PROCEDURES

- Determined the transactions that contained a SKU List Price for Non-Core Items (\$9,200,967.37)
- Calculated the total (undiscounted list price) for these items (\$16,247,630)
- Stratified the population based on the expected discounts as provided in the VENDOR proposal while also considering the non-contract items that COH purchased (See Table 4)
- Recalculated the expected spend based on the expected discounts (See Table 4)
- Compared the amount COH paid to the recalculated amount and noted the difference (See Table 2)
- Applied the discount in percentage to the remaining Non-Core items that didn't have a SKU List Price (See Table 3)

Based on the results of recalculating the expected discounts as proposed by the VENDOR and included within the MA (Exhibit A), the COH was overcharged **\$2,274,654** related to \$9,200,697.37 in purchases (See Table 4)

The remaining amount of purchases that *did not* have SKU list prices provided by the VENDOR was **\$9,980,901.64**. Of that amount, **\$3,811,608.53** represented Non-Core Items subject to the discount structure outlined. By using the discount percentage calculated as shown in Column (h) of Table 4 to the remaining population of Non-Core items, yielded an additional **\$942,329.92** in overcharges.

NOTE: Under this Methodology, all Core Item purchases (**\$6,169,945.93**) were assumed to be accurately charged to the City, which from Method 1, comparison to Dallas County is not the case. Thus the Recalculated Discount Method has a conservative approach in determining the overcharges.

TABLE 3 RECALCULATED DISCOUNT METHOD SUMMARY	
TABLE 4 – RECALCULATED DISCOUNT – NOT CORE ITEMS WITH SKU LIST PRICE	\$2,274,654
TABLE 5 – RECALCULATED DISCOUNT – APPLIED DISCOUNT	\$ 942,330
TOTAL OVERCHARGE – RECALCULATED DISCOUNT METHOD	\$3,216,984



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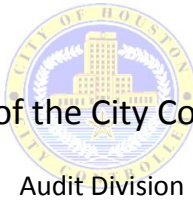
TABLE 4
Recalculated Discount Method
Non-Core Items – with SKU List Price

(a) Number of Transactions w/ List (Undiscounted) Price	(b) Total Undiscounted Price	USC Program Spending Patterns according to VENDOR Proposal		Discounted Prices according to VENDOR Proposal and USC Program History		(g) COH Purchase Price/What COH Paid	(h) What COH should have paid as a % of What COH Actually paid	(i) Overcharge (in\$)
		(c) %	(d) \$	(e) Discount %	(f) Net to Buyer/What COH should have paid \$		Column (f)÷(g)	(Column (g) - (f))
176,845	\$16,247,630	70%	\$11,373,341	70%	\$3,412,002	\$9,200,697	75.28%	
		15%	\$2,493,770	45%	\$1,371,574			
		15%	\$2,380,519	10%	\$2,142,467 *			
			\$16,247,630		\$6,926,043			
Total Overcharge								\$2,274,654

* = Column C Percentage represented Non-Core and Non-Contract Items in proportion to actual spend/usage

TABLE 5
Recalculated Discount Method
Non-Core Items – without SKU List Price
Applied Discount

(a) Number of Transactions w/out List (Undiscounted) Price	(b) COH Purchase Price/What COH Paid	(c)	(d) Net to Buyer/ What COH should have paid\$	(e) Component 2 Overcharge
		NOTE: Column (h) from TABLE 1		(Column (b) - (d))
64,985	\$3,811,609	75.28%	\$2,869,279	
Overcharge – Applied Discount				\$942,330



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(3) LOWEST PRICE COMPARISON METHOD (BY TRANSACTION LINE)

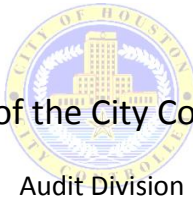
AUDIT PROCEDURES

- Matched purchase transactions to Customer Price Lists (**CPL**) by effective dates for all the public agencies (Houston, Dallas County, and City and County of San Francisco)
- Separated the unmatched records
 - a. Identified items that were not Core
- Compared the amounts that COH paid to the lowest price available using the three customer price lists.
- Recalculated and compared the amount that would have been paid for each jurisdiction to the amount COH paid considering each transaction subject to the lowest price (See Table 6)
- Using the unmatched records from second procedure shown above
 - (1) Applied the results for each jurisdiction to the remaining population (See (1) below)
 - (2) Applied the **VENDOR** proposal information to the applicable items to the items that were not Core (See (2) below and Table 7)

\$15,174,420 of the total \$19.1 Million in purchases that had prices that could be compared when considering all three jurisdiction’s customer price lists, while the remaining **\$4,007,832** could not (see page 17). Table 6 below shows the results of the amounts compared.

TABLE 6 LOWEST PRICE COMPARISON METHOD (BY TRANSACTION LINE) SUMMARY	
MATCHED PURCHASE TRANSACTIONS TO COMPARATIVE CPL	\$2,404,486
(1) APPLIED DISCOUNT	\$ 641,253
TOTAL OVERCHARGE (1)	\$3,045,739
MATCHED PURCHASE TRANSACTIONS TO COMPARATIVE CPL	\$2,404,486
(2) NOT “CORE” ITEMS WITH NO COMPARATIVE CPL	\$1,004,869
TOTAL OVERCHARGE (2)	\$3,409,355
<i>This results in a total overcharge for this method of between \$3,045,739 and \$3,409,355</i>	

- Based on the results of direct comparisons to purchases made by the City of Houston to Customer Price Lists, the **VENDOR overcharged the City of Houston at least \$2,404,486** related to **\$15,172,627** of purchases that took place between March 6, 2006 and December 31, 2010. **Thus, the COH should have paid 16% less than it actually did. This is based on our comparison to a limited set of price lists. Should other price list(s) exist that contain lower prices, the COH would be entitled to additional discount(s). (See Table 7)**



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- The remaining **\$4,007,832** of purchasing data provided by the VENDOR could not be compared to any of the CPLs obtained. Of this amount, **\$2,823,716** represented spending on Non-Core Items, subject to the discount structure identified in the contract. This prohibited the Office of the City Controller’s Audit Division from verifying that contract pricing terms were followed and the related discounts were applied accurately. There was no explanation, justification, or reasoning provided by the VENDOR. Therefore, we applied the alternative procedures noted earlier.

RECOMMENDATION: VENDOR should at minimum, apply (1) the same results from the amount that was tested by applying a 16% discount to \$4,007,832 or (2) the discount structure as was provided in the VENDOR proposal (See Table 7). This would equate to either:

(1) **\$641,253** ($4,007,832 * 16\%$)

(2) **\$1,004,869**

TABLE 7 Lowest Price Comparison Method (By Transaction Line) Purchase Transactions Matched to Comparative Customer Price Lists (CPL)				
(a) Source of Customer Price List	(b) Number of Transactions	(c) Total Purchases/What COH paid	(d) Compared Price/What COH should have paid	(e) Component 1 Overcharge
				Column (c) - (d)
San Francisco	101,968	\$4,819,236	\$2,849,944	\$1,969,292
Dallas, Houston Combined	150,441	\$10,355,184	\$9,919,990	\$435,194
Totals	252,409	\$15,174,420	\$12,769,934	
TOTAL Overcharge				\$2,404,486



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TABLE 8 Lowest Price Comparison Method Non-Core Items with No Comparative CPL							
(a) Number of Transactions w/ List (Undiscounted) Price	(b) Total Undiscounted Price	USC Program Spending Patterns according to VENDOR Proposal		Discounted Prices according to VENDOR Proposal and USC Program History		(g) COH Purchase Price/What COH Paid	(i) Component 1 Overcharge (in\$)
		(c) %	(d) \$	(e) Discount %	(f) Net to Buyer/What COH should have paid \$		(Column (g) - (f))
44,166	\$4,850,259	70%	\$3,395,182	70%	\$1,018,554	\$2,823,716	
		30%	\$1,455,078	45%	\$800,293		
			\$4,850,259		\$1,818,847		
TOTAL Overcharge							\$1,004,869



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FINDING #2 – INCOMPLETE VENDOR PRICING INFORMATION

RISK RATING (IMPACT AND MAGNITUDE) = HIGH

BACKGROUND:

In performing the audit procedures to test the accuracy and appropriateness of the amounts charged by VENDOR per contract terms, one objective was to compare what was paid by COH vs. what should have been paid on price listings as provided by VENDOR. The price lists provided should be complete, timely, relevant, and accurate (e.g. all purchases made should have a corresponding customer price for each SKU and should be related to the applicable time frame and effective dates of the relative price list(s)). The VENDOR is responsible for maintaining adequate books and records to validate compliance with contract terms, which include pricing, price changes, discounts, etc.

We obtained files containing the detail purchase activity, and related Customer Price Lists for the contract period from the VENDOR and used this data as a basis for our testing.

FINDING:

\$5,716,877 of purchases did not contain a related customer price for the City of Houston. Without a Customer Price Listing, **\$2,315,995** in Core Items could not be tested under any of the methodologies applied.⁸

RECOMMENDATION: VENDOR should maintain adequate pricing information for the COH to validate and test the accuracy of amounts paid or, at minimum, apply the same results from the amount that was tested.

MANAGEMENT RESPONSE: (SEE EXHIBIT 2)

ASSESSMENT OF MANAGEMENT RESPONSE: (SEE EXHIBIT 3)

⁸ The remaining \$3,400,883.16 which were not Core items were estimated by applying the VENDOR Proposal information (See Methods 2 & 3; Tables 5 and 7, respectively)



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FINDING #3 – NON-COMPLIANCE WITH REQUIRED INFORMATION REQUESTS

RISK RATING (IMPACT AND MAGNITUDE) = MEDIUM

BACKGROUND:

Specific contract terms outlined audit rights of the Lead Agency and all Participating Agencies. In order to plan and perform audit procedures to obtain sufficient and appropriate evidence that supports conclusions related to the stated audit objectives, we requested specific information to substantiate key contract terms, calculations, and conditions.

The following information is pertinent to substantiating the final price charged to COH and in performing other audit procedures:

- **Undiscounted List Prices** are the starting point for calculating the potential discount and final price charged to the Lead Agency and Participating Agencies, in this case COH.
- **Cost** is a term that is based on the final payment from OD to its suppliers to procure items for re-sale to its customers. Therefore, detailed transaction data from OD's general ledger would provide specific purchasing transactions, from which we could select a sample for testing. Source documentation that supports the journal entries would validate the payments made to suppliers, considering their potential discounts. Additionally, this would identify the supplier in cases where wholly or partially owned subsidiaries could charge internal transfer pricing that would need to have its' related gross margin eliminated.
- **Executed Contract Amendments** support agreed upon changes to contract terms and price changes for Core Items.
- **Customer Price Lists** are the final reported prices to the Lead and Participating Agencies based on the product category (Core, Non-Core, etc.).
- **Audit Information** relates to prior audits performed by other entities. This is important in the planning process of an audit because it provides information that; may allow efficiencies for designing and executing audit procedures, reduce potential duplication of efforts, and identify previous findings and any remediation efforts that may have been taken by the VENDOR.
- **Manufacturer** is pertinent in being able to validate 'Cost', (transfer pricing from related parties) and for the potential for product substitution.
- **Detail Purchase Activity** is the reported line item transactional data that should correlate to spending and amounts actually paid by COH to the VENDOR.

Our first Request for Information (RFI) was sent on November 07, 2011 accompanying the Notification Letter communicating; our intent to audit, the primary audit objectives, primary contacts, etc. In responding to our RFI, the VENDOR requested COH Controller's Office Audit Division to sign a non-disclosure agreement (NDA). The City Auditor provided a signed NDA to the VENDOR on December 28, 2011.



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Subsequently, the VENDOR provided copies of some contract information, administrative agreement(s), detailed transaction data, COH pricing information, and a breakout of payment types.

On December 2, 2011, Office Depot's outside legal counsel responded with a letter, refuting and dismissing the request for information as unwarranted and burdensome. We responded to that correspondence on January 13, 2012 with further clarification, citations from contract clauses, professional auditing standards, and a secondary request to provide information. Office Depot's counsel provided another response on February 10, 2012, reaffirming their position and refusing to provide the requested information as required by the contract.

FINDING:

We could not validate the accuracy and completeness of the Customer Price List information provided by VENDOR for the **\$19,182,252** paid by COH, because the VENDOR did not provide:

- All Customer Price Lists information related to the items purchased during the contract term (See **Finding #2** and **DATA ANALYSIS AND VALIDATION SECTION**)
- Full population of Undiscounted List Prices;
- Fully Executed Contract Amendments;
- Full population of prior Audits (two non-substantive abbreviated reviews were provided, but not audits as defined by professional auditing standards nor as required by the contract – which would include other jurisdictions audits/reviews performed relative to this Agreement)
- Cost Information, which would include vendor procurement activity, including but not limited to invoices paid, access to source documents, etc; and Manufacturer Information

The lack of information imposed a limitation on our audit testing and therefore we modified our scope and adjusted our substantive procedures accordingly (See **EXECUTIVE SUMMARY "SCOPE MODIFICATION"** section on page 5). We sought additional CPL information from other public agencies (inside and outside of the MA) to perform comparison testing.

RECOMMENDATION:

Vendor should maintain and update documentation required by the contract.

MANAGEMENT RESPONSE: (SEE EXHIBIT 2)

ASSESSMENT OF MANAGEMENT RESPONSE: (SEE EXHIBIT 3)



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EXHIBIT 1 - RELEVANT CONTRACT REFERENCES AND EXCERPTS

“MASTER AGREEMENT BETWEEN COUNTY OF LOS ANGELES AND OFFICE DEPOT FOR OFFICE AND CLASSROOM SUPPLIES

1.0 PURPOSE

This Office and Classroom Supplies Master Agreement (hereafter "Master Agreement") is made and entered into by and between the County of Los Angeles (hereafter "COUNTY"), and Office Depot (hereafter "VENDOR").

WHEREAS, COUNTY AND VENDOR agree that VENDOR will offer to provide COUNTY. COUNTY employees and others as more fully described herein with Office and Classroom Supplies (Office Supplies only for COUNTY), hereafter sometimes referred to as the ("Product").

WHEREAS, VENDOR is in the business of selling and supplying Office and Classroom Supplies, and

*WHEREAS, VENDOR is **willing and able to offer, deliver, service and support the Product it offers to, COUNTY departments/divisions, COUNTY offices/organizations, COUNTY employees, and any other entities as set forth herein** (hereafter "Customer(s)"). This document, together with the Exhibits identified in Paragraph 1.1 (Priority of Interpretation), defines the scope of this Agreement."*

“MASTER AGREEMENT BETWEEN COUNTY OF LOS ANGELES AND OFFICE DEPOT FOR OFFICE AND CLASSROOM SUPPLIES

“6.2 Prices, Discounts and Changes....

- 6.2.1 *Vendor agrees for the period of this Agreement that prices for products covered herein will be based on a Discount from Manufacturers' current published price lists or Cost Plus Percentage, except for those identified in EXHIBITS A and A-1 as Core Products. Price changes (increases) from price lists will be allowed only on a semi-annual basis on January 1st and July 1st of each contracting year.*
- 6.2.2 *Vendor shall advise the Los Angeles County ISD Purchasing Division in writing of any proposed price increases or manufacturer's discount structure changes, identifying Agreement by number, providing a copy of the proposed price list and/or acceptable evidence of change in manufacturers discount structure. **VENDOR will be responsible for furnishing and delivering approved price lists to all County departments and other participating government entities. It also shall be VENDOR's responsibility to keep COUNTY and participating government entities informed of any other changes.***

NOTE: Amendment #6 modified these clauses by shifting the price change dates to April 1st and October 1st of each contracting year accordingly.



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“6.2.5 Notwithstanding anything herein to the contrary for thirty (30) days from date of delivery to Customer, should Customer find a lower price, offered in Southern California, for the same product payment terms, quantity and delivery terms and conditions set forth in the applicable purchase order and this Agreement, VENDOR shall, upon presentation of authentic, (e.g., sales invoice, advertisement(s) proof of such, immediately refund the difference to Customer.

“23.0 MOST FAVORED PUBLIC ENTITY

VENDOR represents that the price charged to COUNTY in this Agreement do not exceed existing selling prices to other customers for the same or substantially similar items or services for comparable quantities under similar terms and conditions. If VENDOR'S prices decline, or should VENDOR, at any time during the term of this Master Agreement, provide the Same goods or services under Similar quantity and delivery conditions to the State of California or any county, municipality or district of the State at prices below those set forth in this Master Agreement, then such lower prices shall be immediately extended to COUNTY.”

“MASTER AGREEMENT BETWEEN COUNTY OF LOS ANGELES AND OFFICE DEPOT FOR OFFICE AND CLASSROOM SUPPLIES

“36.0 PARTICIPATING MUNICIPALITIES

The COUNTY has designated U.S. Communities Purchasing and Finance Agency (U.S. Communities) as the agency to provide administrative services related to purchases by other governmental entities (Participating Public Agencies) under this Agreement at COUNTY'S sole discretion and option, and upon VENDOR entering into the requisite U.S. Communities Administration Agreement, Participating Public Agencies may acquire items listed in this Agreement Such acquisition(s) shall be at the prices stated in this Agreement, or lower. In no event shall COUNTY be considered a dealer, remarketer, agent or representative of VENDOR.”

U.S. COMMUNITIES ADMINISTRATION AGREEMENT, ATTACHMENT G, PAGE 1

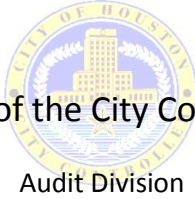
“RECITALS...

Whereas, said Master Agreement provides that any or all public agencies (herein “Participating Public Agencies”) may purchase Product at prices stated in the Master Agreement....”

U.S. COMMUNITIES ADMINISTRATION AGREEMENT, ATTACHMENT H, PAGE 3

“SUPPLIER PROGRAM STANDARDS....

U.S. Communities Administration Agreement - The supplier is required to execute the U.S. Communities Administration Agreement ("Agreement") prior to the award of the U.S. Communities contract. The Agreement outlines the supplier's general duties and responsibilities in implementing the U.S. Communities contract... “



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U.S. COMMUNITIES ADMINISTRATION AGREEMENT, ATTACHMENT H, PAGE 2

“SUPPLIER COMMITMENTS...

Pricing Commitment - A commitment that supplier's U.S. Communities pricing is the lowest available pricing (net to buyer) to state and local public agencies nationwide and a further commitment that, if a state or local public agency is otherwise eligible for lower pricing through a federal, state, regional or local contract, the supplier will match the pricing under U.S. Communities...”

U.S. COMMUNITIES ADMINISTRATION AGREEMENT, ATTACHMENT H, PAGE 5

“PUBLIC AGENCY SOLICITATION RESPONSE GUIDELINES

While it is the objective of the U.S. Communities program to have public agencies piggyback on the contracts rather than issue their own bids and RFPs, U.S. Communities recognizes that for various reasons many public agencies will issue their own solicitations. The following options are available to U.S. Communities Suppliers when responding to Public Agency solicitations.

- 1. Respond to the bid Of RFP with pricing that is higher (net to buyer) than the Suppliers' U.S. Communities contract pricing.*
- 2. Respond to the bid or RFP with pricing that is higher (net to buyer) than the Suppliers U.S. Communities contract pricing. If an alternative response is permitted offer the U.S. Communities contract as an alternative for their consideration.*
- 3. Respond with your U.S. Communities contract pricing: If successful the sales would be reported under U.S. Communities,*
- 4. If competitive conditions required pricing lower than the standard U.S. Communities contract pricing, the supplier can submit lower pricing through the U.S. Communities contract. If successful the sales would be reported under U.S. Communities,***
- 5. Do not respond to the bid or RFP. Make the U.S. Communities contract available to the agency to compare against their solicitation responses.”*

“INTERGOVERNMENTAL AGREEMENT BETWEEN THE CITY OF HOUSTON AND THE COUNTY OF LOS ANGELES; & OFFICE DEPOT (Contract # C61899)

II.

*The Parties agree that County has furnished the City with a copy of the County's Master agreement, which is attached to and made a part of this agreement as Exhibit "B". The City has reviewed the Master Agreement and agrees to fulfill every term contained in the Agreement except for modifications made in Exhibit "A", which is attached to this Intergovernmental Agreement and made a part of the Master Agreement with regard to purchases made by City. **The City is entitled to all rights and shall assume all applicable obligations under the Master Agreement** except for those terms which by their nature are exclusively applicable only to the County.”*



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“MASTER AGREEMENT BETWEEN COUNTY OF LOS ANGELES AND OFFICE DEPOT FOR OFFICE AND CLASSROOM SUPPLIES

8.0 RECORDS, DOCUMENTS AND AUDITS

VENDOR shall maintain accurate and complete financial records of its activities and operations relating to this Agreement in accordance with generally accepted accounting principles. VENDOR shall also maintain accurate and complete employment and other records relating to its performance of this Agreement. VENDOR agrees that COUNTY, or its authorized representatives, shall have access to and the right to examine, audit, excerpt, copy or transcribe any pertinent transaction, activity, or records relating to this Agreement. All financial records, timecards and other employment records, and proprietary data and information, shall be kept and maintained by VENDOR and shall be made available to COUNTY during the terms of this Agreement and for a period of four (4) years thereafter unless COUNTY's written permission is given to dispose of any such material prior to such time. All such material shall be maintained by VENDOR at a location in Los Angeles County, provided that if any such material is located outside Los Angeles County, then, at COUNTY's option, VENDOR shall pay COUNTY for travel, per diem, and other costs incurred by COUNTY to examine, audit, excerpt, copy or transcribe such material at such other location.

*In the event that an audit is conducted of VENDOR specifically regarding this Agreement **by any Federal or State auditor, or by any auditor or accountant employed by VENDOR or otherwise, then VENDOR shall file a copy of the audit report with COUNTY's Auditor/Controller within thirty (30) days of VENDOR's receipt thereof, unless otherwise provided by applicable Federal or State law or under this Agreement. COUNTY shall make a reasonable effort to maintain the confidentiality of such audit report(s).***

Failure on the part of VENDOR to comply with the provisions of this Paragraph 8.0 shall constitute a material breach upon which COUNTY may terminate or suspend this Agreement.”

“INTERGOVERNMENTAL AGREEMENT BETWEEN THE CITY OF HOUSTON AND THE COUNTY OF LOS ANGELES; & OFFICE DEPOT (Contract #C61899)

EXHIBIT “A”

8.0 Inspections and Audits

City representatives may perform, or have performed, (1) audits of Vendor's books and records, and (2) inspections of all places where work is undertaken in connection with this Agreement. Vendor shall keep its books and records available for this purpose for at least four years after this Agreement terminates. This provision does not affect the applicable statute of limitations.”



Office of the City Controller

Audit Division

"MASTER AGREEMENT BETWEEN COUNTY OF LOS ANGELES AND OFFICE DEPOT FOR OFFICE AND CLASSROOM SUPPLIES

EXHIBIT "A"

Tab 3 - Attachment E, 4.0 Office Depot Business Proposal,

*"The pricing information included in Attachments A and C reflects a discount from Manufacturer Suggested List Pricing with an accompanying minimum Gross Profit Percentage Floor according to the bid specification categories as outlined, i.e. (General Office and Stationery Supplies, Toner Items, Furniture, Technology Items and Paper Products) the discounts cover all items in our BSD Catalog. The Pricing is stated in this format: Office Depot will quote a discount from list price structure for the custom Everyday Office Essentials (EOE) catalog, a 4,000+ item subset of the over 14,000 item BSD Catalog. This catalog is currently in use at County of Los Angeles and at existing Participating Public Agencies utilizing the National Office Depot – US Communities program. This discount from list will blanket cover all items in the EOE catalog regardless of the product category. **The over 4,000 item EOE catalog is representative of over 70% of the total spend in the existing Office Depot – US Communities program. The pricing stated for the EOE catalog is LL70% w/15% GP Floor (LL stands for Mfg. List Price Less). In addition, the remainder of the BSD 12 Catalog (over 10,000 items) is priced at LL45% w/15% GP Floor with the exception of Special Products or Items shipped directly from the Manufacturer.** Special Products or items shipped directly from the Manufacturer are noted in our catalog with an S or M. Pricing for these items will be LL10%"*

NOTE: Exhibit A is from the VENDOR response to the Lead Agency's request for proposal (RFP), which became incorporated as part of the contract.

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Vendor Management Responses

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September 21, 2012

Via First Class Mail and E-Mail

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Re: Draft Audit Report

Dear Ms. Hanahan and Mr. Schroeder:

Per your request, and as discussed during our teleconference on September 6, 2012, I am writing to respond to the draft audit report ("Report") produced by the City Auditor in connection with the City's purchase of office supplies from Office Depot in the 2006 to 2010 time period.

The Report sets forth two "summary conclusions": (1) Office Depot did not comply with the "lowest price guarantee" in the relevant contract, resulting in the City being overcharged more than \$3 million and (2) Office Depot breached other contract terms by not providing the City Auditor with certain requested information. Office Depot believes that both of those conclusions are unfair and incorrect, as detailed below.

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The Intergovernmental Agreement and the L.A. County Contract

The contract under which the City's relevant purchases were made was the "Intergovernmental Agreement between the City of Houston and the County of Los Angeles; & Office Depot," dated March 27, 2007 ("IGA"). The IGA incorporated by reference the terms of a separate contract, Master Agreement No. 42595 between Office Depot the County of Los Angeles ("L.A. County Contract").

The L.A. County Contract was a group purchasing contract under the auspices of the U.S. Communities Government Purchasing Alliance ("U.S. Communities"), of which the City was a member. That is, it allowed U.S. Communities members to purchase items from Office Depot at the prices negotiated by L.A. County. Group purchasing arrangements are intended to be advantageous for purchasers and sellers. Because the contract is bid out and executed by a single "lead agency," piggybacking purchasers avoid the substantial costs of independently soliciting and evaluating bids. In effect, they ride on the coattails of the lead agency, which negotiates and monitors compliance with the contract (usually receiving an administration fee as compensation).

Group purchasing also makes things simpler and less costly for sellers. Not only does it reduce the number of bids that must be written and submitted, it greatly reduces a seller's administrative burdens. Rather than having to monitor and ensure compliance with the terms of hundreds or even thousands of individual contracts, the seller need only administer a single contract, dealing with a single counterparty.

Response to Summary Conclusion 1: Alleged Non-Compliance with MFC Provision

From the Report and our conversations with you, we understand that the methodology employed by the City Auditor in connection with Summary Conclusion 1 was to compare the prices paid by the City during the March 2006 through December 2010 contract period against "price lists" obtained from two other Office Depot customers, the City and County of San Francisco and Dallas County, in order to see if the City's prices were lower.





There are a number of serious problems inherent in that methodology. But before delving into them, we note that the Report does not distinguish between overcharges attributed to San Francisco pricing being lower and overcharges attributed to Dallas County pricing being lower. Because both the City and Dallas County were U.S. Communities members buying under the terms of the L.A. County Contract, the pricing they received was, for the most part, identical. Any discrepancies would be different in nature and amount compared to potential discrepancies vis-à-vis the San Francisco contract. Based on our discussions and past experience, we understand that the vast majority of the \$3 million in purported overcharges stems from the comparison to San Francisco pricing, so that is the focus of our analysis here.


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 Most of the total purported overcharges in the Report derive not from application of an accounting or auditing principle, but from a legal conclusion—i.e., the assumption that, on any given item, the City was contractually entitled to the price San Francisco was charged if that price was lower. That assumption—which calls for legal analysis outside an auditor’s expertise—reflects a misunderstanding of the facts and a misinterpretation of the relevant contract terms.

 First, the Report erroneously looks at compliance with the L.A. County Contract’s most-favored-customer (MFC) provision on an item-by-item basis. In fact, the actual parties to the contract always understood that compliance with the MFC provision was measured on the basis of overall “spend” (i.e., the total cost of all items purchased)—even if some individual items cost more under the L.A. County Contract. For example, while Contract X might have offered pencils at a lower price than the L.A. County Contract, and Contract Y might have offered paper clips at a lower price than the L.A. County Contract, when you considered the basket of goods purchased by an average customer over time, if the overall cost was less expensive on the L.A. County Contract than on Contract X or Y, there would be no violation of the MFC provision.¹ The Report therefore should have looked at overall spend, rather than cherry-picking individual items.

 Second, the correct spend to use in determining MFC compliance is L.A. County’s, not that of the City or any other piggybacking customer. The IGA granted the City rights and obligations under the L.A. County Contract “except for those terms which by their nature are exclusively applicable only to [Los Angeles] County.” IGA ¶ II. And under the L.A. County Contract, Los Angeles County exclusively had the ability to enforce the most-favored-customer provision, thereby safeguarding the bargained-for pricing for all piggybacking entities.² At most,

¹ *Accord* Ex. A (“[T]he ‘lower pricing’ to be matched is overall pricing based on a Participating Public Agency’s overall reasonable and regular spending pattern on a broad spectrum of core and non-core items and not individual line items within a Participating Public Agency’s total spend.” (emphasis added)); Ex. B (excerpt of L.A. County 2010 RFP Amendment #1) (“Q. Section 1.33.1, Most Favored Public Entity Could the County clarify that compliance with this provision will be based on aggregate, overall pricing? A. It is based on the aggregate.” (emphasis added)); *accord United States ex rel. Dale v. Starkey Labs., Inc.*, No. Civ. 01-709(DWF/SRN), 2004 WL 2065127, at *5 (D. Minn. Sep. 8, 2004) (holding, in case alleging failure to comply with most-favored-customer provision, that “Plaintiffs will have to show that the terms negotiated by the VA when considered as a whole were not as favorable as those negotiated by other purchasers” (emphasis added)).


² Consistent with the purposes of a group purchasing contract, the L.A. County Contract distinguished carefully between the rights of Los Angeles County as lead agency (referred to as “COUNTY”, *see* L.A. County Contract § 1.0) and the rights of piggybacking “customers”


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 therefore, the MFC provision obligated Office Depot to ensure that L.A. County's overall spend was less than or equal to what L.A. County's spend would have been under a comparable contract. As long as that test was satisfied, Office Depot was in compliance, irrespective of whether the idiosyncratic spend of one of the many piggybacking customers might have been less expensive on a comparable contract. The Report therefore should have tested compliance using L.A. County's spend, not the City's.

 Third, the San Francisco contract was not an appropriate comparator. The L.A. County Contract pegged the MFC obligation to contracts with other California governmental entities that involved similar quantity, terms, and conditions. See L.A. County Contract § 23.0. The San Francisco contract indisputably did not meet those criteria. First and foremost, its maximum total quantity was expressly limited to \$10 million (later amended to just over \$18 million). In contrast, the L.A. County Contract allowed unlimited quantities, and involved sales volumes upwards of \$600 million per year. In addition, unlike the L.A. County Contract, the San Francisco contract (i) was exclusive; (ii) did not allow for nationwide piggybacking; (iii) had a unique, specially tailored core items list; (iv) had a unique list of restricted items; and (v) did not provide for rebates. The Report does not appear to have considered any of these significant differences in deciding to utilize the San Francisco contract as a comparator in the audit.

 Fourth, the Report does not use the prices San Francisco was actually charged under its contract. Rather, the comparison was based on "price lists" provided by San Francisco's

(defined to include "Participating Public Agencies" of the U.S. Communities program, *see id.* §§ 1.0, 36.0). As lead agency, virtually all rights under the contract were vested exclusively with Los Angeles County. For example, only Los Angeles County could extend the contract, *id.* § 5.2; only Los Angeles County could amend the contract's provisions, *id.* § 3.1; only Los Angeles County could approve price increases, *id.* § 6.2.3; and only Los Angeles County could terminate the contract, *id.* §§ 15.0-19.0.

 In contrast, the L.A. County Contract grants U.S. Communities members only limited rights. Essentially, U.S. Communities members are entitled to buy items from Office Depot at the prices set forth in the contract—nothing more:

At COUNTY'S sole discretion and option [U.S. Communities members] may acquire items listed in the Agreement . . . at the prices stated in this Agreement, or lower.

Id. § 36.0.


 The most-favored-customer provision at issue in the Report applies exclusively to "COUNTY." *Id.* § 23.0. It does not refer at all to "customers" or "Participating Public Agencies."

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auditors, which were created in the context of a contract dispute between San Francisco and Office Depot, and which reflected the prices those auditors claimed, after the fact, should have been charged. In our call earlier this month, the City Auditor did not seem to be aware of this fact and instead appeared to be under the mistaken impression that “price lists” provided to it reflected actual prices. By adopting, wholly and without question, the San Francisco auditors’ subjective and self-serving interpretations of the San Francisco contract, the Report imports the following methodological errors:

- **Calculation of Non-Core “Expected Discount” Value**

The Report’s calculation of overcharges turns on San Francisco’s calculation of the “Expected Discount” it claimed should have applied to all items not on the San Francisco contract’s “section A” list. That 70% figure was derived from inapposite data, using a questionable weighting methodology.



The “Expected Discount” used by San Francisco was calculated using 2003 usage data to populate the “List Dollars” column in San Francisco’s analysis. That data is not the best measure of actual usage under the Office Depot contract for two primary reasons. First, purchases in 2003 were from a different vendor (or vendors), with a different product assortment (purchased from different manufacturers) than that offered by Office Depot. Second, the types and volumes of products purchased by San Francisco in 2003 were not necessarily the same types and volumes of products that were purchased in 2005—much less in 2009. These two factors virtually guarantee that the purchasing basket on which San Francisco’s “Expected Discount” figure was based did not accurately reflect San Francisco’s actual purchasing pattern under the Office Depot contract.

Additionally, in its pricing analysis, San Francisco artificially chose to weight its purchases based on the total list prices, instead of weighting the purchases based on total actual expenditures, which would have resulted in a lower “Expected Discount” figure. A weighting based on actual expenditures would more accurately capture the purpose of the analysis, in that a list-price-based weighting necessarily skews the average toward the higher-discount categories.

- **Disregard of Allowed Non-Core Price Increases**

By utilizing San Francisco’s revisionist price lists, the Report adopts San Francisco’s unfair and absurd position that no price changes were allowed over the five-year life of the San Francisco contract. In fact, the San Francisco contract explicitly allowed list prices to increase quarterly, following changes in manufacturers’ list prices, up to the amount of increase in the Western Region

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CPI for that quarter. By ignoring those contractually permissible price increases, the price lists generated by San Francisco are incorrectly low, necessarily resulting in purported “overcharges.”

- **Application of Contractual Discounts to Non-Contract Items**

 The Report also adopts the erroneous position that San Francisco was entitled to receive contractual discounts on non-contract items. In calculating the purported “overcharge” amount, the San Francisco auditors assumed that items that were not on San Francisco’s “price lists” would have been subject to the same “overcharge/error rate” as items that were on the lists. In fact, to the extent such items were available under the San Francisco contract at all, they were non-contract items and thus would not have received a contract discount—much less the incredibly steep 70%-off discount that underlies the overcharge figures for items on the price lists. Again, the effect of this assumption is to vastly overstate “overcharges.”

 Even if one were to assume that the San Francisco contract was an appropriate comparator, however, the fact of the matter is that Office Depot’s pricing complied with the MFC provision. Had the City Auditor correctly compared the actual prices charged to the City of Houston versus the actual prices charged to San Francisco, he would have seen that Los Angeles County’s spend from 2006 to 2010 was less expensive under its contract than it would have been under the San Francisco contract. Thus, there was no violation of the MFC provision.

Response to Summary Conclusion 2: Alleged Failure to Provide Information

Summary Conclusion 2 states that Office Depot “was not compliant with other key contract terms” because certain information “required to be provided to Participating Agencies” was not provided by Office Depot. As discussed in our teleconference earlier this month, that statement is incomplete and misleading.

The specific items identified in the Report as not having been provided, and Office Depot’s response with respect to each, are as follows:


-  “Detail Cost Information supported by VENDOR purchasing activity”: Office Depot provided cost information for all of the City’s usage in the transaction database transmitted to you on January 17, 2012. We also offered to make additional cost information to you, to the extent you felt it necessary, but you declined that offer.
- “All Audit Reports performed on the VENDOR (primarily those that are relevant to the agreements or similar agreements)”: As Office Depot has previously pointed out to you,

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this assertion bears little resemblance to the actual contractual duty, which was to file with L.A. County a copy of any audit report of the L.A. County Contract created by a state or federal auditor. L.A. County Contract § 8.0. Notwithstanding the fact that there were no such audits, Office Depot voluntarily provided you with all of the audits of the contract conducted by L.A. County and/or U.S. Communities. The City Auditor's request for any audit conducted by any of the 10,000+ U.S. Communities members over the five-year term of the contract, plus other audits conducted by non-U.S. Communities customers, was both unduly burdensome and far beyond what the City is entitled to.



- “Manufacturer identification”: There is absolutely nothing in the L.A. County Contract that required Office Depot to keep “manufacturer identification” records. Moreover, as has been previously explained, it is not uncommon in the office supplies industry for items to be sourced from multiple vendors (who in turn may obtain the item from multiple manufacturers), depending on time, location, and availability. Therefore, it is practically impossible to record “manufacturer identification” for every transaction.



- “Executed Contract Amendments that may have changed prices to Core Items”: This statement leaves out the fact that you were provided with all of the relevant contract amendments; your only complaint was that not all of them were signed. The Report also neglects to mention that L.A. County (the party whose signature is missing) was well aware of the amendments and has never taken the position that they were invalid.
- “Semi-Annual price list changes for Non-Core Items (from Core to Non-Core, etc.)”: This information was included in the price plan history and net pricers that were provided to you.



- “Support for changes of product classifications”: Setting aside the fact that the L.A. County Contract did not require Office Depot to keep such records, the City Auditor never asked for them (apart from a generic demand for all contract amendments, discussed above). Furthermore, it is not even clear what is being referring to, as changes to the core list did not typically involve any formal documentation: The parties discussed changes, Office Depot created and submitted to L.A. County a new list, and L.A. County had the opportunity to object if it wished. *See* L.A. County Contract § 6.2.

Reimbursement of Genuine Pricing Discrepancies

In the course of explaining the methodology used to reach the conclusions in the Report, you informed us during our recent teleconference that some portion of the total “overcharge” amount set forth in the Report derived not from the City Auditor’s interpretation and application

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of the MFC provision of the L.A. County Contract, but from instances in which the City was charged an amount different from the amount set forth on Office Depot's own pricing records. You were not able at that time to quantify the amount attributable to such discrepancies, but Office Depot undertook to do so by performing its own analysis using the same data you were provided.

Office Depot has done its analysis and has determined that genuine pricing discrepancies resulted in a small number of overcharges to the City (amounting to less than 1% of the City's total purchases). Those overcharges were dwarfed by discrepancies resulting in substantially larger undercharges, such that, all told, the discrepancies benefited the City more than they cost it. Nonetheless, as part of its commitment to pricing accuracy and customer satisfaction, Office Depot is willing to reimburse the City in the full amount of the overcharges. Please contact me to discuss the specifics.

* * *

We appreciate the opportunity to respond to the Report. In light of the many serious errors and seemingly biased assumptions that underpin its analysis, however, we dispute its conclusions and ask that they be revised to more accurately reflect the facts and law. If you have any questions about the foregoing points, or if you require any additional information, please do not hesitate to let me know. I also reiterate my request that all communications regarding this matter be directed to me and Ms. Stern, and not to Office Depot business people.

Sincerely,



Paul T. Hourihan

cc: Heather Stern, Esq. (via e-mail)

EXHIBIT 2
Vendor Management Responses

Exhibit A

EXHIBIT 2

Vendor Management Responses

U.S. Communities' Suppliers Price Matching Obligation

The purpose of this document is to clarify U.S. Communities' intent with regard to U.S. Communities' Suppliers price-matching obligation of the Pricing Commitment set out in Attachment H of the Administration Agreement between U.S. Communities and Office Depot dated November 8, 2005.

U.S. Communities Administration Supplier Agreements have a price-matching obligation that is not a Most Favored Nations Clause applicable to any public agency contract held by Supplier, but rather, is an Eligible Public Agency Clause ("EPA"). The EPA requires the Supplier to match pricing for any U.S. Communities Participating Agency only if that Participating Public Agency would be eligible to receive lower pricing by purchasing through an alternative public agency contract held by the Supplier. See U.S. Communities Pricing Commitment Attachment H in relevant part: "... if a state or local agency is otherwise eligible for lower pricing through a federal, state, regional or local contract, the Supplier will match the pricing under U.S. Communities."


If the pre-condition of eligibility is met as set out in the EPA, the Supplier then has an obligation to match the lower pricing for any agency that would be eligible to buy under the lower contract.  With regard to all commodity contracts, such as office supplies, U.S. Communities' intent is that the "lower pricing" to be matched is overall pricing based on a Participating Public Agency's overall reasonable and regular spending pattern on a broad spectrum of core and non-core items and not individual line items within a Participating Public Agency's total spend.. This total spend approach ensures that the eligible Participating Public Agency receives the best overall comparative value of either the U.S. Communities Supplier contract or the alternative public agency contract held by the Supplier, whichever is lower overall.

EXHIBIT 2
Vendor Management Responses

Exhibit B

EXHIBIT 2

Vendor Management Responses

RFP-IS-10255020 AMENDMENT #1

Office Products & Services - Questions and Answers + Revised paper quantities

1. Q: How should a vendor bid on items on the core list that are not available to them.

A: The items listed on the core lists that are not marked with an asterisk (*), must be offered as the stated manufacturer's product. For example, if the manufacturer for a label is Avery, then bidders must price that specific item.

For items that are marked with an asterisk (*), bidders may offer their generic or private branded item of equal or greater quality in the same unit of measure.

2. Q: If an alternate brand is indicated by an asterisk, can we offer an alternate brand other than what is listed and how do we show that on the spreadsheet?

A: For items that are marked with an asterisk (*), bidders may offer their generic or private branded item of equal or greater quality in the same unit of measure.

3. Q: Are 3 years of financial statements required to be submitted?

A: Page 35, paragraph 2 details that 2 prior fiscal years of financial statements are required.

4. Q: Please clarify if SBE preference will apply to the local portion of the RFP.

A: For this solicitation, the Local Small Business Preference will not be applied as stated in the solicitation on page 16, section 1.29.

5. Q: Can you provide a list of reman manufacturers?

A: The current approved list of reman manufacturers, that are STMC certified, are listed below. The specifications have been revised and any manufacturer offered must meet the revised specifications.

Printing Technology Inc. (PTi)

West Point Products

Micro Solutions Enterprises (MSE)

EXHIBIT 2

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Could the County clarify the definition of a "subcontractor" for purposes of this RFP? For example, would third-party logistics vendors and outsourced customer service providers be excluded from the definition of "subcontractor" under this Section 1.33.1 I?

A: Third-party logistics vendors such as UPS, Fed Ex, common carriers, etc shall not be considered a subcontractor for the purposes of this solicitation. Outsourced customer service providers would be considered subcontractors for this solicitation and must be approved by the County.

19. **Q:** Section 1.33.1, Most Favored Public Entity, page 18,3" paragraph
If the Supplier's prices decline, or should the Supplier at any time during the term of this Master Agreement provide the same goods or services under similar quantity and delivery conditions to the State of California or any county, municipality, or district of the State at prices below those set forth in this Contract, then such lower prices shall be immediately extended to the County. Could the County clarify that compliance with this provision will be based on aggregate, overall pricing?

A: It is based on the aggregate.

20. **Q:** Section 1.7, Master Agreement Term, page 3,1st paragraph
The Master Agreement term shall be for a period of three (3) years from the date of the award, with two (2) additional 12-month extension options which may be exercised at the sole discretion of the County
Can the parties mutually agree in writing to the two (2) additional 12-month extensions?

A: Any extension to a resulting agreement from this solicitation shall be at the sole discretion of the County and mutually agreed upon in writing by all parties.

21. **Q:** Section 1.4, Minimum Mandatory Requirement, page 2, 4th paragraph
Proposer must have three (3) years experience, within the last five (5) years, providing office supplies and products equivalent or similar to the services provided to the County.
Are the minimum mandatory requirements applicable to **each** independent dealer(s) that may be participating in a consortium offering?

A: Yes

22. **Q:** To have access to questions and answers and updates are we required to register in some fashion even though we may not be bidding directly?

A: The County will make available to anyone, the answers to questions through an Amendment which will be posted to the County website. It will also be available on the US Communities website.



Office of the City Controller

Audit Division

Exhibit 3 – Audit Division Assessment of Management Responses:

Page numbers correspond to the response letter provided by Williams and Connolly LLP on behalf of Office Depot Management.

Page 2

Response to Summary Conclusion 1: Alleged Non-Compliance with MFC Provision

¶2

Price lists were chosen because specific purchasing activity information was not available for disclosure from either Dallas or San Francisco. Professional Standards require alternative procedures be considered to the extent the audit objectives can be met with sufficient and appropriate evidence. Further, price lists are the VENDOR's representation of what should be paid. By definition, discrepancies between what was paid vs. the price list are deemed to be an error, unless the price lists are not reliable. In this case, the data used was provided by the VENDOR who is attesting that the information is correct.

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¶1

In planning and executing an audit that renders conclusions, the audit procedures performed are required to yield sufficient and appropriate evidence from which to base those conclusions. The Office of the City Controller's Audit Division is in compliance with both the Generally Accepted Government Auditing Standards (GAGAS) as issued by the Government Accountability Office (GAO) and the International Standards for the Professional Practice of Internal Auditing issued by the Institute of Internal Auditors (IIA). We have an external review (peer review) to valid adherence to the professional of our policies, procedures, proficiency, competency, professional development, quality assurance. Throughout the course of the engagement, the audit division obtained interpretations of contract terms from the City Legal department. The consensus from those meetings created the criteria that became the foundation for testing.

¶2

The auditors/ Controller's Audit Division performed a test of compliance on overall spend. In order to make this comparison, the baseline becomes what is defined as overall spend. The city of Houston total spend could be different than Dallas or San Francisco. The options we explored are presented in the detailed audit report.

¶3

Negotiating the MA that only provides the Lead Agency pricing guarantees defeats the purpose of the CO-Op arrangement.



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¶1

Management response indicates that compliance with LA MA implies/satisfies compliance with all participating agencies (PA's). The IGA executed by the COH has an audit clause specific to the IGA and COH. This grants explicit rights for the COH to audit according to the agreement by inheriting its' terms. It is counter-intuitive to assume VENDOR compliance with all PA's by auditing the lead agency's specific purchasing activity. The COH would then have the right to audit our purchase applying to the master-agreement terms and conditions as appropriate. To be able to conclude that the vendor is selling products to COH/PA consistent with the MA requires validation of that claim by direct testing of our purchases as party to the agreement.

¶2

Exhibit H, Page 5, Paragraph V of the administration agreement between Office Depot and USC gave explicit instructions (limited options) on how Office Depot was to bid or respond to RFP for office supplies with other governmental agencies. The framework of the protocol was to maintain the integrity of the "Co-op" efforts applied through USC.

¶3

The City and County of San Francisco was not allowed to provide or disclose purchase information. Assuming, however that contract terms are followed, the customer price list should equal the amount paid. Absent purchase information, we elected to use price lists, per GAGAS Section 6.40 and 6.41

Page 4 Footnotes

¶1

Also, in management's response, it was indicated that "only LA County could terminate the contract." The IGA is an agreement that inherited the MA, while modifying some of its' clauses. IGA page 3 paragraph IV gives COH the exclusive right to terminate the IGA, which would detach the COH as a PA to the MA.

¶4

"COUNTY" as defined in the MA is defined as the County of Los Angeles and also the Lead Agency to the Master Agreement. The Intergovernmental Agreement incorporates the terms and conditions. Where Los Angeles County has separate terms are indicated in Section 37.0 "Exclusions". Also, as noted above the protocol for Office Depot to bid on other government agencies business is outlined in the Administrative Agreement Exhibit H, page 5 paragraph V. This is consistent with the concept of cooperative purchasing arrangements by leveraging buying power and giving incentives to the vendor in negotiating contracts where the bid process originates outside of the Co-op. The Administrative Agreement ensured "best price to government agencies" by requiring OD to apply one of the steps outlined in Exhibit H page 5, paragraph V. Any contracts negotiated for prices lower than the MA, were to run through the MA under USC. Additionally, the IGA between COH, OD, and LA County adopts the pricing terms in the MA. (para. H) To take the position that LA County had more favorable terms than the Participating Agencies makes the Co-Op of no benefit to any public agency.



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Calculation of Non-Core “Expected Discounts” Value

Office Depot settled with San Francisco for approximately 80% of their reported claim, which supports the substantive reliability of the judgment they applied.

Page 6

Application of Contractual Discounts to Non-Contractual Items

Management responses are critical of San Francisco’s methodology, however as stated earlier, they settled for approximately 80% of the reported overcharge. San Francisco’s price lists were used as the basis for the calculation of overcharges imposed by Office Depot.

¶13

The Auditor used 3 methodologies to verify compliance by the VENDOR. One of them was the "overall spend" using COH actual purchases and recalculating what that same volume would have been under each of Dallas and SF pricing structures (Net to Buyer Method). This showed significant overcharges. (See Detailed Finding #1)

Response to Summary Conclusion 2: Alleged Failure to Provide Information

“Detail Cost Information supported by VENDOR purchasing activity”.

OD provided a self-reported Cost. This requires audit procedures to verify the accuracy. Validating information is fundamental to the Audit Process. OD never offered or provided the information as COH requested.

We look to the Administrative Agreement to guide Office Depot’s business practices in dealing with government agencies.

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¶11

The request is related to a professional standard – GAGAS 6.36; 6.41. The reports provided were not audits, but agreed upon procedures with a limited scope, using qualified language stating the report was not an assurance or opinion.

Second Bullet

“Manufacturer Identification”

The request is to validate cost as it pertains to related party suppliers, and subsidiaries, etc.

Third Bullet

“Executed Contract Amendments”

The documents provided by Vendor were not signed (fully executed) and therefore do not represent sufficient and appropriate evidence to rely on the validity of the amendments



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Fifth Bullet

“Support for changes to product classifications”

As indicated in the report "Data Validation and Analysis" section, changing the SKU classification had the direct effect of reducing the discount percentage, thus increasing the amount paid by COH.

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This document has no identification of source, is not signed or dated. The substance and effect of the VENDOR's should be supported by a formally executed document. This document reportedly did not exist until after 2009 (3+ years into the contract, subsequent to significant settlements with the VENDOR).

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The Audit tested the Overall spend as indicated earlier - See Detailed Finding #1, Method 1 (Net to Buyer) Calculation.