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STATE OF NEW YORK  
OFFICE OF THE STATE COMPTROLLER

August 17, 2004

Mr. Kenneth J. Ringler Jr.  
Commissioner  
NYS Office of General Services  
Empire Plaza, Corning Tower  
Albany, NY 12242

Re: Report 2004-F-7

Dear Mr. Ringler:

Pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution, and Article II, Section 8 of the State Finance Law, we have followed up on the actions taken by the Office of General Services (OGS) to implement the recommendations contained in our audit report, *Sysco Foods Service Inc., Contract PC54751* (Report 2001-R-1).

**Background, Scope and Objectives**

OGS provides essential support services for the operations of State government. In an attempt to promote more cost-effective government, OGS entered into approximately 2,000 centralized service or commodity contracts on behalf of State agencies. One such "prime vendor" contract was awarded to Sysco Food Services - Albany (Sysco), a division of the Sysco Corporation, to provide some 1,200 food, household and sundry items to more than 170 selected State facilities (e.g., Department of Corrections, Office of Mental Health, etc.), as well as eligible non-State facilities. Contract PC54751 originally covered the period May 1, 1999 through April 30, 2002, and was extended through October 31, 2003. The annual value of this contract approximated \$61 million. The contract was renewed and currently covers the period November 1, 2003 through October 31, 2008.

Pursuant to the contract, Sysco is required to secure the best possible "Net New York State Delivered Price" for all goods covered by the contract that are selected by, and provided to, user agencies. The Net New York State Delivered Price is defined as the price Sysco pays to its suppliers, plus freight charges for delivery of goods to Sysco's warehousing facilities, less allowable manufacturer discounts and allowances, plus a percentage "margin on sale" (upcharge). These various upcharges are based on a formula outlined in the contract's invitation for bid. Sysco is also required to provide OGS and user agencies with periodically updated price guidelines to aid them in preparing their purchase orders to Sysco.

Our initial audit report, which was issued October 23, 2002 assessed contractor compliance with contract terms, quantified and assessed the rationale for the discounts and allowances that Sysco was not passing along to the State, and determined whether OGS was adequately monitoring Sysco's obligations pursuant to the contract. We found that Sysco had been passing along the discounts and allowances specifically negotiated in the contract with the State, and specified as Category 1, 2, 3 or 4. However, we noted that Sysco received certain other manufacturer discounts and allowances, such as fees for merchandising services and performance-based discounts, that were not passed on to the State. Some of these discounts were specifically excluded by the contract terms, and others were not addressed in negotiating the contract. These discounts and allowances generally fell into Category 4. We also found that OGS had been inconsistent in applying adequate contract oversight. As a result, the State did not always get the best Net New York State Delivered Price from this contract. The objective of our follow up, which was conducted in accordance with Generally Accepted Government Auditing Standards, was to assess the extent of implementation, as of June 30, 2004, of the three recommendations included in our initial report.

### **Summary Conclusions and Status of Audit Recommendations**

We found that OGS officials have made progress in correcting the problems we identified. However, additional improvements are needed. Of the three initial audit recommendations, OGS officials have implemented two recommendations, and partially implemented one recommendation.

### **Follow-up Observations**

#### **Recommendation 1**

*Before awarding any future "prime vendor" food contracts:*

- a. Assess the appropriateness of the allowances Sysco receives and classifies as Merchandising Services Fees.*
- b. For those allowances inappropriately classified as such (e.g., Category 4), ensure that they are appropriately classified as allowances that are passed on to the State.*

Status - Implemented

Agency Action - Prior to awarding the current contract, OGS assessed the rebates and allowances historically passed on to the State by Sysco. As part of this assessment, they compared Sysco's practices in this area to industry practices. As a result, OGS clarified the language in its new contract with Sysco to specifically exclude the category of Merchandising Services Fees from rebates or allowances passed on to the State. OGS also assessed those rebates and allowances not passed along to the State. The current contract reflects the determinations made by OGS. We suggest that, as the nature of these rebates and allowances can change over time, OGS continue to assess their applicability before awarding any future prime vendor food contracts.

**Recommendation 2**

*Establish agreed upon procedures with Sysco and user agencies to document their efforts to secure the best possible prices for contracted items.*

Status - Partially Implemented

Agency Action - OGS uses various techniques to help secure the best possible prices for contracted items. One such technique used by OGS is benchmarking, which uses a computer program to identify month to month pricing changes. OGS then determines the reason for the more significant changes. In addition, OGS, using the Producers Price Index (PPI), compares Sysco pricing to other regional grocery contracts. However, OGS has not established formal, agreed upon procedures with Sysco to document Sysco's efforts to secure the best possible price.

**Recommendation 3**

*Monitor Sysco's pricing practices and conduct periodic on-site audits to ensure that Sysco's product costs are in compliance with contract terms.*

Status - Implemented

Agency Action - OGS performs monthly audits to ensure product costs are in compliance with contract terms. One of these audits is done on-site at Sysco each year. We reviewed 12 such monthly audits and found that they met the goal of our recommendation.

Major contributors to this report were Frank Patone and Michael Filippone.

We would appreciate your response to this report within 30 days, indicating any actions planned to address the unresolved issues discussed in this report. We also thank the management and staff of the Department for the courtesies and cooperation extended to our auditor during this process.

Very truly yours,

William P. Challice  
Audit Director

cc: Robert Barnes