

***State of New York  
Office of the State Comptroller  
Division of Management Audit  
and State Financial Services***

**OFFICE OF GENERAL SERVICES  
OVERSIGHT OF THE  
PRIME VENDOR FOOD CONTRACT**

**REPORT 96-S-77**



***H. Carl McCall***  
*Comptroller*



# State of New York Office of the State Comptroller

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## Division of Management Audit and State Financial Services

### Report 96-S-77

Mr. Joseph J. Seymour  
Commissioner  
Office of General Services  
Corning Tower  
Empire State Plaza  
Albany, NY 12242

Dear Mr. Seymour:

The following is our report on the Office of General Services' oversight of the prime vendor food contract with SYSCO Food Services.

This audit was done according to the State Comptroller's authority as set forth in Section 1, Article V of the State Constitution and Section 8, Article 2 of the State Finance Law. We list major contributors to this report in Appendix A.

*Office of the State Comptroller  
Division of Management Audit  
and State Financial Services*

April 28, 1998

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# Executive Summary

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## Office Of General Services Oversight Of The Prime Vendor Food Contract

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### Scope of Audit

In 1995, the Office of General Services (OGS) awarded a statewide prime vendor food contract to SYSCO Food Services (SYSCO) to provide agencies with food, and other commodities. OGS has extended the food contract with SYSCO through April 30, 1999. Sales under this contract are about \$50 million annually.

The contract allows commodity prices to fluctuate with market conditions. SYSCO provides a core list of about 1,000 frequently purchased commodities whose prices are set for 7 days for items such as meat and poultry or 30 days for items such as canned goods. Prices for other commodities may fluctuate daily. Altogether, SYSCO offers more than 9,000 commodities for purchase by State agencies.

The State's price for commodities is based on SYSCO's cost plus a fixed percentage markup. An item's cost is defined as the price paid by SYSCO to its supplier plus applicable freight charges. To its cost, SYSCO may add its markup ranging from 6 to 6.75 percent. The markup is to cover SYSCO's administrative and overhead costs as well as its profit.

Our audit addressed the following question relating to the State's contract with SYSCO:

- Has OGS established adequate controls to monitor the prices charged under the State's prime vendor food contract?

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### Audit Observations and Conclusions

We found that OGS's monitoring controls were generally adequate. For the most part, SYSCO provides commodities to the State at competitive prices. Also, the Department of Correctional Services, the contract's largest State customer, has reported success in using this contract to reduce its inventory costs and to achieve savings in food purchases. While overall results have been positive, the numerous commodities with continuously fluctuating prices presents considerable opportunity for pricing errors which may improperly inflate costs. Thus, constant and careful monitoring is required by OGS.

OGS has performed a number of price comparisons of SYSCO commodities to ensure the prices charged are competitive. OGS reports that SYSCO's prices are consistent with or better than the other contracts that were used for comparison. OGS also found that SYSCO's prices were consistent with the marketplace as indicated by the published indexes for various commodities. We compared prices for 76 commodities between SYSCO and other vendors having food contracts with New York State. We found that SYSCO had the lowest price 85 percent of the time. (See pp. 4-5)

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Although the prices SYSCO charges State agencies are generally lower than what other vendors charge State entities, we believe there are opportunities for the State to achieve lower prices. We compared the prices paid to suppliers by SYSCO to the prices paid to suppliers by the other State contract vendors, and found that SYSCO was paying its suppliers a higher price for 30 of the 76 commodities. Based on its size and ability to purchase in bulk, we believe SYSCO generally should be able to obtain commodities at prices consistent with or lower than these other vendors. Since the price the State pays is based on SYSCO's cost plus a markup, it is important that OGS regularly compare prices paid to suppliers on a sample basis. Where SYSCO's costs are higher, OGS should work with SYSCO to see if more favorable costs can be obtained. (See p. 5)

OGS has done some price verifications to determine whether commodity prices were accurately computed by SYSCO. Results of testing by OGS and ourselves indicate that pricing errors (overcharges and undercharges) do occur. Thus, there is a need for ongoing monitoring of SYSCO's pricing. In the most recent contract extension, OGS has added language that provides for additional testing procedures. However, the price verification testing will mostly be done at OGS's offices and rely on photocopies of SYSCO's original documentation. Using original documentation rather than photocopies would provide greater assurance that records have not been altered. If it is not possible for OGS to receive original documents from SYSCO, then OGS should use other means to verify the accuracy of the submitted documents, including making site visits, on a sample basis, to compare the photocopied documents to the originals. (See pp. 6-7)

SYSCO has agreements with many of its suppliers to provide cost reductions, in the form of allowances, discounts and rebates specifically for items SYSCO sells to the State. These cost reductions should be reflected in SYSCO's pricing and the savings passed along to the State. However, these cost reductions usually are not reflected on suppliers' invoices to SYSCO. OGS should require SYSCO to identify which commodities being price tested are covered by agreements with suppliers that provide for cost reductions and the amount of such reductions, as well as obtain SYSCO's certification that commodities for which no such agreements were identified indeed have no cost reductions. OGS should then confirm with SYSCO's suppliers that the discount information provided is correct. (See pp. 6-9)

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## **Comments of Agency Officials**

Draft copies of the matters contained in this report were provided to agency officials for their review and comment. Their comments were considered in preparing this report and are included as Appendix B. Agency officials agreed with our conclusions and recommendations.

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Major Contributors to This Report

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## Appendix B

Response of Agency Officials

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# Introduction

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## Background

In anticipation of closing its Division of Supply Support in favor of privatizing the operation, the Office of General Services (OGS) solicited bids for a prime vendor contract to provide agencies with food, food-related products and other commodities. A prime vendor is expected to offer a multitude of products and/or services required by the State. While prime vendors have been used by the Federal government and others, this was the first prime vendor contract let by OGS.

OGS solicited bids for this contract using a market basket approach wherein bids are evaluated based on the review of a representative sample of widely used commodities. A contract let using a market basket approach covers a multitude of products ranging from hundreds to thousands of different items. Typically, the State's commodity contracts have covered just one commodity or a single type or class of commodity.

OGS awarded the prime vendor contract to SYSCO Food Services (SYSCO). Under the original contract, SYSCO supplied agencies in the downstate area, including metropolitan New York City and Long Island, for the three month period of July 1 through September 30, 1995. OGS then solicited bids for a multi-year contract that included agencies statewide. Based on the response to the statewide request for proposal, OGS determined that the State's best interest would be served by extending the contract with SYSCO through April 30, 1997 and expanding the contract to cover the entire State. OGS coordinated with the Office of the State Comptroller (OSC) in bidding, awarding and extending this contract. OGS, in coordination with OSC, has extended SYSCO's prime vendor contract another two years, through April 30, 1999.

The prime vendor contract with SYSCO does not set commodity prices but allows them to fluctuate with market conditions. SYSCO provides a core list of about 1,000 more frequently purchased commodities. Core list commodity prices are set for 7 days for items such as meat and poultry or 30 days for items such as canned goods. Prices for other commodities may fluctuate daily. Altogether, SYSCO offers more than 9,000 commodities for purchase by State agencies. Agencies do have the option to purchase commodities offered by SYSCO from other sources. In fact, several commodities available from the SYSCO contract are also offered through other State contracts.

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The State's price for commodities is based on SYSCO's cost plus a fixed percentage markup. An item's cost is defined as the price paid by SYSCO to its supplier plus applicable freight charges. To its cost, SYSCO may add its markup ranging from 6 to 6.75 percent. The markup is to cover SYSCO's administrative and overhead costs as well as its profit. Annual sales under this contract are about \$50 million.

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## **Audit Scope, Objective and Methodology**

We audited the OGS oversight and monitoring of the prime vendor contract with SYSCO for the period July 1, 1995 through March 31, 1997. Our audit objective was to determine whether OGS had established adequate controls to monitor SYSCO's pricing under the contract.

To accomplish our objective, we assessed OGS's monitoring efforts, compared SYSCO pricing for a judgmental sample of commodities to other vendors and other State contracts for reasonableness, and tested a second judgmental sample of SYSCO's prices to determine their accuracy. In addition, we interviewed officials and staff from OGS, OSC, other State agencies, SYSCO and other State vendors. We did not review agency procedures for verifying that the quantity and quality of commodities ordered were, in fact, received.

We did our audit according to generally accepted government auditing standards. Such standards require that we plan and do our audit to adequately assess those procedures and operations of OGS included within the audit scope. Further, these standards require that we understand OGS's internal control structure and compliance with those laws, rules and regulations that are relevant to OGS's procedures and operations which are included in our audit scope. An audit includes examining, on a test basis, evidence supporting transactions recorded in the accounting and operating records and applying such other auditing procedures as we consider necessary in the circumstances. An audit also includes assessing the estimates, judgments, and decisions made by management. We believe that our audit provides a reasonable basis for our findings, conclusions and recommendations.

We use a risk-based approach when selecting activities to be audited. This approach focuses our audit efforts on those procedures and operations that have been identified through a preliminary survey as having the greatest probability for needing improvement. Consequently, by design, we use our finite audit resources to identify where and how improvements can be made. Thus, we devote little audit effort to reviewing procedures and operations that may be relatively efficient or effective. As a result,

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our reports are prepared on an "exception basis." This report, therefore, highlights those areas needing improvement and does not address activities that may be functioning properly.

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## **Response of Agency Officials**

Draft copies of the matters contained in this report were provided to agency officials for their review and comment. Their comments were considered in preparing this report and are included as Appendix B. Agency officials agreed with our conclusions and recommendations.

Within 90 days after final release of this report, as required by section 170 of the Executive Law, the Commissioner of the Office of General Services shall report to the Governor, the State Comptroller, and the leaders of the Legislature and fiscal committees, advising what steps were taken to implement the recommendations contained herein, and where recommendations were not implemented, the reasons therefor.

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# OGS Oversight of the SYSCO Prime Vendor Contract

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According to OGS's Policy and Procedure Guide Number 5, Section E, OGS's responsibility does not cease at the letting of the contract. It is their policy to administer their contracts fairly and vigorously, ensuring that all contract terms, conditions and specifications are met and that any deficiencies that arise are corrected promptly.

Because this contract is a cost-plus contract with continuously fluctuating prices, effectively monitoring SYSCO's pricing practices is important to ensure that the State pays a fair and competitive price. Due to the size and complexity of this contract, OSC's Pre Audit unit expressed concerns about the State's ability to audit purchases under this contract to ensure agencies were charged an appropriate price. Based on these concerns, OGS accepted responsibility for monitoring SYSCO's pricing through spot checks of invoices, comparison with pricing in previous periods, and comparison with competitors on other grocery contracts. The most recent contract renewal provides for expanded testing procedures. Our report focuses on additional improvements needed to ensure monitoring is effective.

In an October 9, 1996 memo to OSC seeking to extend the prime vendor contract with SYSCO, OGS officials state that there was little substantive competition when the request for proposal for the statewide contract was advertised. In fact, SYSCO was the only responsive bidder. The OGS memo also states that if another vendor were to replace SYSCO, the transition would be disruptive for the agencies and costly to the State. By virtue of the size of the contract, SYSCO holds a strong position in its dealings with the State.

Based on our testing, we believe that SYSCO generally provides commodities to the State at competitive prices. Also, the Department of Correctional Services, the largest State customer of the prime vendor food contract, has reported that this contract has helped to reduce its inventory costs and to achieve savings in food purchases. While overall results have been positive, the numerous commodities with continuously fluctuating prices presents considerable opportunity for pricing errors which may improperly inflate costs. This will require constant and careful monitoring by OGS.

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## Price Comparisons

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Over the period of the contract, OGS has performed a number of price comparisons of SYSCO commodities. For a nine month period, OGS compared SYSCO's prices for a sample of nine high volume commodities to prices listed in the Wall Street Journal. For various samples of commodities, OGS also compared SYSCO's prices to those of a hospital association that purchase food in quantity, to those of the statewide contractors for the States of Connecticut, Maine and Ohio and to vendors holding group home food contracts with New York State. After the contract was let, OGS trended SYSCO prices over time to identify significant price changes.

OGS reports that SYSCO's prices are consistent with or better than the other contracts that were used for comparison. OGS also found that SYSCO's prices were consistent with the market as indicated by the published indexes. We judgmentally selected 100 commodities which SYSCO reported as its highest sellers to the State, based on the dollar amount of sales. We found 76 comparable commodities sold by other vendors having food contracts with New York State. We compared SYSCO prices with those of the other vendors for these 76 items. We found that SYSCO had the lowest price 85 percent of the time, which is consistent with OGS's findings.

Although the prices SYSCO charges State agencies are generally lower than what other vendors charge State entities, we believe there are opportunities for the State to achieve even lower prices. For example, we compared the prices paid to suppliers by SYSCO to the prices paid to suppliers by the other State contract vendors, and found that SYSCO was paying its suppliers a higher price for 30 of the 76 commodities. SYSCO had annual sales of nearly \$11 billion in 1995 and is a much larger company than the other vendors we used for comparison. For example, the next largest vendor had annual sales of \$40 million. Based on its size and ability to purchase in bulk, we believe SYSCO generally should be able to obtain commodities at prices consistent with or lower than these other vendors. Since the price the State pays is based on SYSCO's cost plus a markup, it is important that OGS regularly compare prices paid to suppliers on a sample basis. Where SYSCO's costs are higher, OGS should work with SYSCO to see if more favorable costs can be obtained.

OGS has proposed to regularly match SYSCO prices for high volume items with published indexes to assess whether SYSCO prices are consistent with the marketplace. OGS has also taken steps to monitor SYSCO's costs paid to suppliers and begun to require SYSCO to explain

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why costs of applicable commodities are higher than costs of other vendors.

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## **Price Verifications**

After awarding SYSCO the prime vendor contract, OGS began performing price verification tests. These tests involved a review of suppliers' invoices, freight bills and other documentation for a sample of commodities. The purpose of the test was to determine whether these commodities' prices were accurately computed by SYSCO.

We performed a price verification test for a judgmental sample of 100 commodity purchases made in the period September 10 through October 15, 1996. In our selection process, we ensured that we chose a wide variety of products which were sold throughout the State. For each purchase, we obtained documentation from SYSCO on its cost and freight charges. We then calculated the selling price of each commodity using the contract markup rates and compared that to the amount charged on the invoice. We found 6 errors involving price calculations. The errors included four overcharges ranging from 1 percent to 20 percent and two undercharges of less than 1 percent.

The errors we found were generally of low dollar value when considered individually. For example, the greatest discrepancy was an overcharge of \$3.05 per case of yams that had a selling price of \$15.56. Other errors were all less than \$1.00 per case. Tests conducted by OGS resulted in similar findings. The impact of these errors is dependent on the quantity of related items purchased by the State. We did not determine the overall impact of these errors during our audit.

In preparing for the most recent contract extension, OGS has added language to the prime vendor contract that provides for additional testing procedures. On a monthly basis, OGS will select 40 commodities, mostly from the Albany warehouse. For each commodity, OGS will request invoices, freight bills and related materials. SYSCO will supply the requested materials within 5 working days for commodities shipped from Albany and 10 working days for commodities from SYSCO's other distribution centers. OGS will use the requested information to calculate the appropriate price and verify it to the price list.

However, we understand that the price verification testing will mostly be done at OGS's offices and rely on photocopies of SYSCO's original documentation. Using original documentation rather than photocopies would provide greater assurance that records have not been altered. If it

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is not possible for OGS to receive original documents from SYSCO, then OGS should use other means to verify the accuracy of the submitted documents, including making site visits, on a sample basis, to compare the photocopied documents to the originals.

Another important aspect of price verification involves supplier allowances, discounts and rebates. It is a common practice for wholesalers like SYSCO to have agreements with their suppliers to offer allowances, discounts and rebates. Many of SYSCO's suppliers provide cost reductions specifically for the items SYSCO sells to the State through its contract. These cost reductions should be reflected in SYSCO's pricing and the savings passed along to the State.

To adequately monitor this cost-plus contract, OGS must be aware of these agreements and consider all allowances, discounts and rebates when calculating the proper sale price. However, these cost reductions usually are not reflected on suppliers' invoices to SYSCO. Also, SYSCO has not provided OGS with the agreements it has with its suppliers.

When performing its price monitoring, OGS must rely on SYSCO to acknowledge whether the commodities being reviewed had any allowances, discounts or rebates. Similarly, we were dependent on SYSCO to indicate the existence of any cost reductions when we performed our price verification testing. No documentation is readily available to support whether an allowance, discount or rebate was offered by SYSCO's suppliers. As such, we cannot be certain that SYSCO provided us with all allowances, discounts and rebates during our price verification tests.

Of the 100 items we sampled for price verification, SYSCO identified cost reductions for 38 items. These cost reductions can significantly reduce SYSCO's cost for commodities. For the 38 items, the cost reductions ranged from 1 percent to 56 percent of SYSCO's cost before freight.

By relying on SYSCO to identify all cost reductions, neither we nor OGS can independently determine the appropriate commodity price when carrying out pricing tests. In its price monitoring, OGS should require SYSCO to identify which commodities being tested are covered by agreements with suppliers that provide for cost reductions and the amount of such reductions. OGS should also obtain SYSCO's certification that commodities for which no such agreements were identified indeed have no cost reductions. OGS should then confirm with SYSCO's suppliers that the discount information provided by SYSCO about the commodities being tested is correct.

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The SYSCO contract is a substantial contract offering a large number of products with frequently changing prices. Results of testing by OGS and ourselves indicate that pricing errors (overcharges and undercharges) do occur. As a result, there is a need for ongoing monitoring of SYSCO's pricing.

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## **Recommendations**

1. In addition to price comparisons already being done, compare SYSCO's prices paid to suppliers to those of other State vendors and follow up with SYSCO when opportunities for savings are identified.

2. Require SYSCO to provide access to the original documents when conducting tests or develop alternate means to test their validity.

(OGS officials responded that original documents were reviewed during previous on-site audits at SYSCO, and will continue to be reviewed in future on-site audits.

Our recommendation is directed at the monthly price verification tests by OGS of 40 selected SYSCO commodities and not at the annual on-site audits. According to OGS procedures, the monthly price verification tests are to be done in the Albany OGS office. As such, SYSCO will supply copies of the documentation requested by OGS for review. We believe that, for these monthly tests, OGS should either obtain originals or take some steps to verify that the copies are complete and accurate. Such a step may include making site visits to SYSCO to compare a sample of photocopied documents to the originals.)

3. For the commodities being tested, require SYSCO to identify which commodities are covered by agreements with suppliers that provide for allowances, discounts and rebates and the amount of such cost reductions, and to certify that all cost reductions have been identified.

4. Verify with SYSCO's suppliers that all the discount information provided by SYSCO is correct.

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# Major Contributors to This Report

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William Challice  
David R. Hancox  
Carmen Maldonado  
Dominick Vanacore  
Brian Lotz  
Tom Riley  
Craig Coutant  
Len Milano  
Randy Partridge  
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DIRECTOR OF  
FINANCIAL ADMINISTRATION

March 9, 1998

Mr. William Challice  
Director  
Office Of The State Comptroller  
Division Of Management Audit  
and State Financial Services  
270 Broadway, 19<sup>th</sup> Floor  
New York, New York 10007

Dear Mr. Challice:

Thank you for the opportunity to respond to Draft Report 96-S-77, Oversight Of The Prime Vendor Food Contract.

Your report finds that the contractor, SYSCO Food Services, generally provides commodities to the State at competitive prices. Specifically, when your auditors compared prices between SYSCO and other New York State food contractors, SYSCO had the lowest price 85 percent of the time. The report also points out that the contract's largest customer, the Department of Correctional Services, has reported a reduction in inventory costs and a savings in food purchases. In addition, with the approval of OSC, the original contract term was extended two years, through April 30, 1999.

Many of the points raised in the draft report were previously discussed and addressed during meetings between staff of this office and OSC. Through a cooperative working relationship, a number of techniques were jointly developed for monitoring this contract.

Relative to the specific recommendations contained in the report, the following have been implemented:

RECOMMENDATION 1

In addition to price comparisons already being done, compare SYSCO's prices paid to suppliers to those of other State vendors and follow up with SYSCO when opportunities for savings are identified.



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**"OGS ... COMMITTED TO TOTAL CUSTOMER SATISFACTION"**



OGS ACTION

This is already being done. Documentation of comparisons was part of the submission to OSC for the extension of the contract.

RECOMMENDATION 2

Require SYSCO to provide access to the original documents when conducting tests or develop alternate means to test their validity.

OGS ACTION

Original documents were reviewed during previous on-site audits. OSC has been invited to participate in the next on-site audit, which will again include a review of such documents.

RECOMMENDATION 3

For the commodities being tested, require SYSCO to identify which commodities are covered by agreements with suppliers that provide for allowances, discounts and rebates and the amount of such cost reductions, and to certify that all cost reductions have been identified.

OGS ACTION

Agreements with suppliers have been provided by the contractor every month for the commodities being tested. This will continue and has been noted in OGS monthly submissions to OSC. We will immediately require SYSCO to certify that all cost reductions have been identified for the commodities being tested.

RECOMMENDATION 4

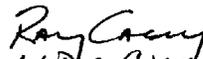
Verify with SYSCO's suppliers that all the discount information provided by SYSCO is correct.

OGS ACTION

In the past, SYSCO's suppliers have viewed this information as being confidential and proprietary. By working with the contractor, OGS has developed an inquiry letter that we will begin to use immediately to secure this information for specific invoices.

We value the cooperative working relationship evident during the audit process. The resultant modification of pricing review procedures will only serve to improve this cost effective contract. We also appreciate OSC's recognition of the value of this contract, and the effectiveness of our review procedures.

Sincerely,

  
Ray Cooney  
1st Dep. Commissioner  
for Joseph J. Seymour