

PERFORMANCE AUDIT REPORT

Vendor Discounts To Agencies

**A Report to the Legislative Post Audit Committee
By the Legislative Division of Post Audit
State of Kansas
April 1988**

PERFORMANCE AUDIT REPORT

VENDOR DISCOUNTS TO STATE AGENCIES

OBTAINING AUDIT INFORMATION

This audit was conducted by Curt Winegarner, Auditor, of the Division's staff. If you need any additional information about the audit's findings, please contact Mr. Winegarner at the Division's offices.

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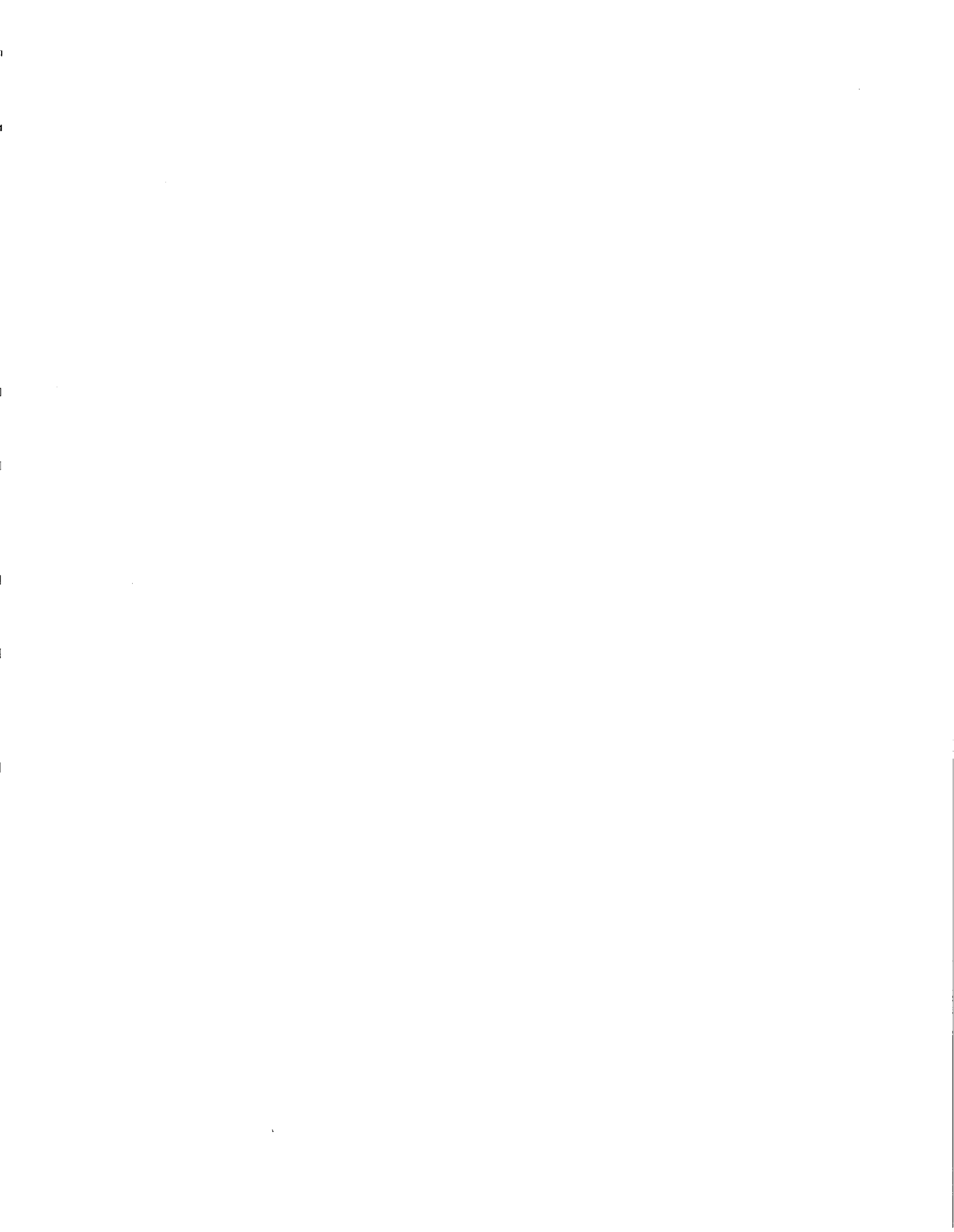
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VENDOR DISCOUNTS TO STATE AGENCIES

Summary of Legislative Post Audit's Findings

To what extent are State agencies not taking advantage of vendor discounts available to them? The auditors found that some discounts are made available to agencies under contracts with the State, while others are offered on vendors' invoices at the time of purchase. Because the Division of Accounts and Reports does not receive copies of invoices, it is only able to verify that State agencies take advantage of discounts available to them under State contracts. The auditors reviewed a sample of 213 State purchases totalling approximately \$194,000 and found 37 purchases in which a discount opportunity existed. Of these, State agencies failed to take advantage of 12, representing a cost of \$160. Most of the discounts lost were prompt payment discounts for which the agency failed to meet the payment deadline. The auditors' sample was not drawn to be representative of the State as whole. But if it were representative, the auditors estimate that the fiscal year 1987 loss to the State for the types of goods included in the sample would have been about \$70,000 out of approximately \$53 million in purchases.



VENDOR DISCOUNTS TO STATE AGENCIES

Vendors who sell goods to State agencies sometimes offer to discount the full price of the goods. This discount may be a specified percentage off the listed price (for example, 20 percent off the list price), or it may be what is called a “prompt payment” discount (for example, a certain percentage off the list price if paid within 10 days or by the 10th of the following month). Legislative concerns have been raised that State agencies are not always taking advantage of such vendor discounts, resulting in higher costs than necessary.

To address these concerns, the Chairperson of the Legislative Post Audit Committee directed the Legislative Division of Post Audit to conduct a special 100-hour performance audit that addressed the following question:

To what extent are State agencies not taking advantage of vendor discounts available to them?

To answer this question, the auditors interviewed officials from the Division of Purchases and the Division of Accounts and Reports regarding State purchasing policies. They also interviewed officials from a sample of State agencies regarding their procedures for taking advantage of discount opportunities. Finally, the auditors reviewed a sample of purchases made by State agencies, and determined the number and dollar value of discounts those agencies failed to take advantage of.

To What Extent Are State Agencies Not Taking Advantage of Vendor Discounts Available to Them?

The auditors reviewed 213 purchases totalling approximately \$194,000 and found 37 purchases in which a discount opportunity existed. Of these, State agencies failed to take advantage of 12, representing a cost of \$160. Generally, discounts were lost because the agency failed to satisfy the discount terms. These and other findings are discussed in the sections that follow.

Two Types of Discounts Are Available to State Agencies

One type of discount is a discount off the full list price. In this case, the vendor offers to automatically deduct a certain percentage from the stated list price of goods purchased by a State agency. Another type of discount is called a “prompt payment” discount. Here the vendor offers to take a certain percentage off the list price if the agency pays within a specified time period. For example, the vendor might reduce the price by 2 percent if the agency pays within 10 days or by the 10th of the following month.

Some discounts are offered by vendors under contracts with the State, while others are offered at the time of purchase.

The Division of Accounts and Reports is only able to verify that agencies take advantage of discounts available to them under State contracts. Auditors of the Division's Administrative Audit Section review all vouchers submitted by State agencies before authorizing payment. If the items purchased are on a State contract, the auditors check to make sure that the purchase is in compliance with the terms of the contract. If an agency fails to take advantage of a discount available to it, the Administrative Audit Section rejects the voucher and sends it back to the agency to be corrected and resubmitted. The Section's staff estimate that less than one percent of the 2,000 vouchers they reject each month are rejected for this reason.

On the other hand, the Division is not able to routinely verify that agencies have taken advantage of discounts offered outside of or in addition to State contracts. Discounts offered by vendors at the time of purchase are usually signified on the vendors' invoices, which are not submitted to the Division of Accounts and Reports with the vouchers. Because the Division does not receive a copy of the invoice, it has no way of knowing whether a discount was offered. For this reason, the auditors focused their review on this latter category of purchases.

**The Auditors Reviewed a Sample of 213 Purchases
And Found 37 That Involved a Discount Opportunity**

The auditors asked officials from the Division of Purchases and the Division of Accounts and Reports to suggest categories of goods that are commonly discounted by vendors. They then selected a sample of 213 expenditures made for these types of goods by six State agencies between March 1 and March 11, 1988. Thirty purchases were selected randomly from each agency, together with all purchases greater than \$2,000. The six agencies and the types of goods included in the sample were:

Agencies Included in Sample

Department of Administration	University of Kansas Medical Center
Department of Corrections	Dept. of Social and Rehabilitation Services
University of Kansas	Department of Transportation

Types of Goods Included in Sample^(a)

Food for human consumption	Data processing supplies
Building materials and supplies	Agricultural supplies and materials
Other maintenance and construction supplies	Household, laundry, and kitchen supplies
Automotive parts and supplies	Office furniture, fixtures, and equipment
Stationary and office supplies	

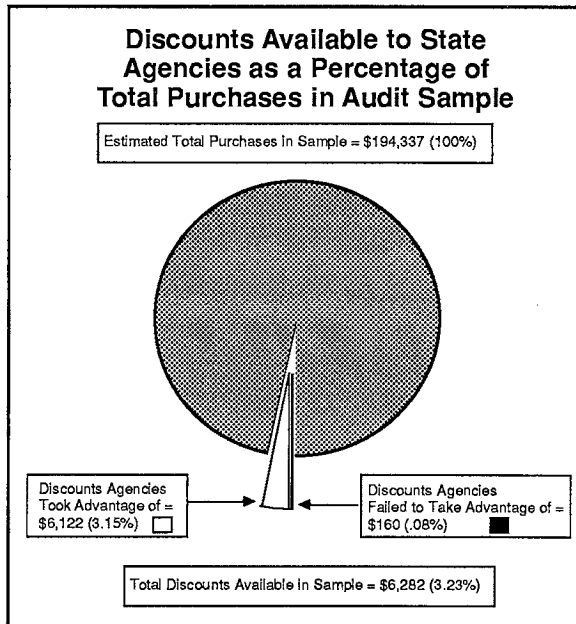
(a) These categories of goods correspond with the following object codes in the State's central accounting system: 320, 341, 349, 359, 371, 372, 391, 392, and 403.

The auditors visited each agency and reviewed the vouchers and invoices for the sample purchases. Of the 213 purchases the auditors reviewed, 37 (17 percent) had a discount opportunity indicated on the voucher or invoice. These discounts amounted to \$6,282 and applied to goods worth \$40,066. Twenty-five of the 37 discounts were offered on the vendor's invoice at the time of purchase and could not have been veri-

fied by the Division of Accounts and Reports. The rest were offered under the terms of a State contract and could be verified.

Agencies Failed to Take Advantage Of 12 Discount Opportunities

Of the 37 discounts available, agencies took advantage of 25 discount opportunities worth \$6,122, but failed to take advantage of 12 worth \$160. The discounts lost represented less than one-tenth of one percent of the approximately \$194,000 worth of goods purchased in the auditors' sample. Given the timeframe of this audit, the sample drawn was not representative of the State as a whole. But if it were representative, the auditors estimate that the fiscal year 1987 loss to the State for the types of goods included in the sample would have been nearly \$70,000 out of about \$53 million in purchases.

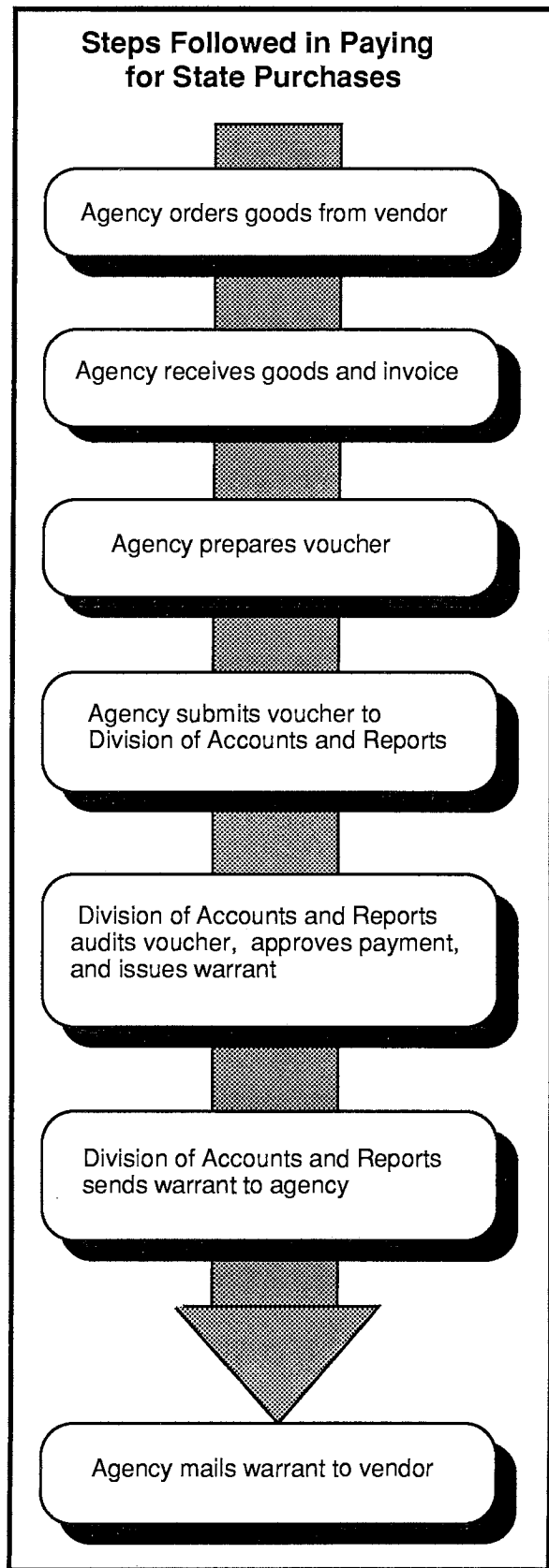


The 12 discount opportunities agencies failed to take advantage of are detailed in the accompanying table. (Appendix A lists the 25 discount opportunities that agencies took advantage of.)

Discounts Agencies Failed to Take Advantage Of

<u>Agency</u>	<u>Discount Terms</u>	<u>Compliance Wth Terms^(a)</u>	<u>Amt. of Discount Forgone</u>
University of Kansas	2% by 10th of following month	Terms met	\$13.05
Dept. of Transportation	5% by 10th of following month	Terms met	.47
Dept. of Transportation	1% within 10 days	Terms met	21.27
Dept. of Administration	2% within 10 days	4 days past deadline	.93
Dept. of Corrections	1% within 10 days	17 days past deadline	2.67
University of Kansas	1% within 10 days	17 days past deadline	21.53
KU Medical Center	2 % within 10 days	33 days past deadline	.56
KU Medical Center	2% within 10 days	11 days past deadline	.96
KU Medical Center	1% within 10 days	13 days past deadline	37.63
KU Medical Center	1% within 10 days	11 days past deadline	48.72
KU Medical Center	1% by 10th of following month	28 days past deadline	1.08
KU Medical Center	2% by 10th of following month	1 day past deadline	10.81
Total			<u>\$159.68</u>

(a) To determine whether agencies complied with the terms of a discount, the auditors counted the number of days from the date the goods or invoice was received (whichever was later) to the date the warrant was issued. If the date the goods or invoice was received was not available, the auditors counted from the invoice date.



As the table shows, all the discounts not taken advantage of were prompt payment discounts in which the agency was required to pay within a specified amount of time. In three of these cases, the agency actually met the terms of the discount but failed to deduct it from the amount paid to the vendor.

In the remaining nine cases, the agencies did not meet the terms of the discount. Most of the discount terms required the agency to pay within 10 days. The amount of time by which agencies exceeded the deadline for payment ranged from one day to 33 days, and averaged 15 days.

Agency officials cited several reasons for failing to meet the terms of prompt payment discounts. Officials of the Department of Social and Rehabilitation Services, the University of Kansas, and the University of Kansas Medical Center said that delays inherent in the State's payment system (such as the amount of time required to prepare and approve vouchers, mail them to Topeka, and obtain warrants from the Division of Accounts and Reports) often made it impossible to meet discount terms, particularly 10-day terms. Officials of several agencies also indicated that staff place less emphasis on meeting the terms of vendor discounts when they have other priorities to deal with, or when the value of the discount is relatively small.

The Division of Accounts and Reports has a procedure called a "24-hour special," which agencies can use to have vouchers processed on a more timely basis. To use the procedure, an agency attaches a special tag or message to the vouchers that need immediate attention. The Division reviews and approves these vouchers on a daily basis. According to

Division officials, a warrant is usually returned to the agency within one or two business days. Although some agencies have used this procedure to help meet the terms of prompt payment discounts, it is intended to be used primarily in emergency situations. To keep the number of vouchers down to a manageable level, the Division encourages agencies to use discretion in requesting the procedure. The auditors noted one instance in the sample in which this procedure was used. In that case a warrant was issued within six days of the invoice date, and the vendor's terms were satisfied.

Some State agencies, including the Departments of Transportation and Social and Rehabilitation Services and the University of Kansas, key vouchers into computers and send them to the Division of Accounts and Reports on magnetic tapes. Officials of the Division indicated that this method generally reduces the amount of time needed to process vouchers for payment. However, many agencies, including the Departments of Administration and Corrections and the University of Kansas Medical Center, have not developed the capability to use this procedure.

In Three Instances, An Agency Took Advantage of a Discount Even Though it Did Not Meet the Terms of the Discount

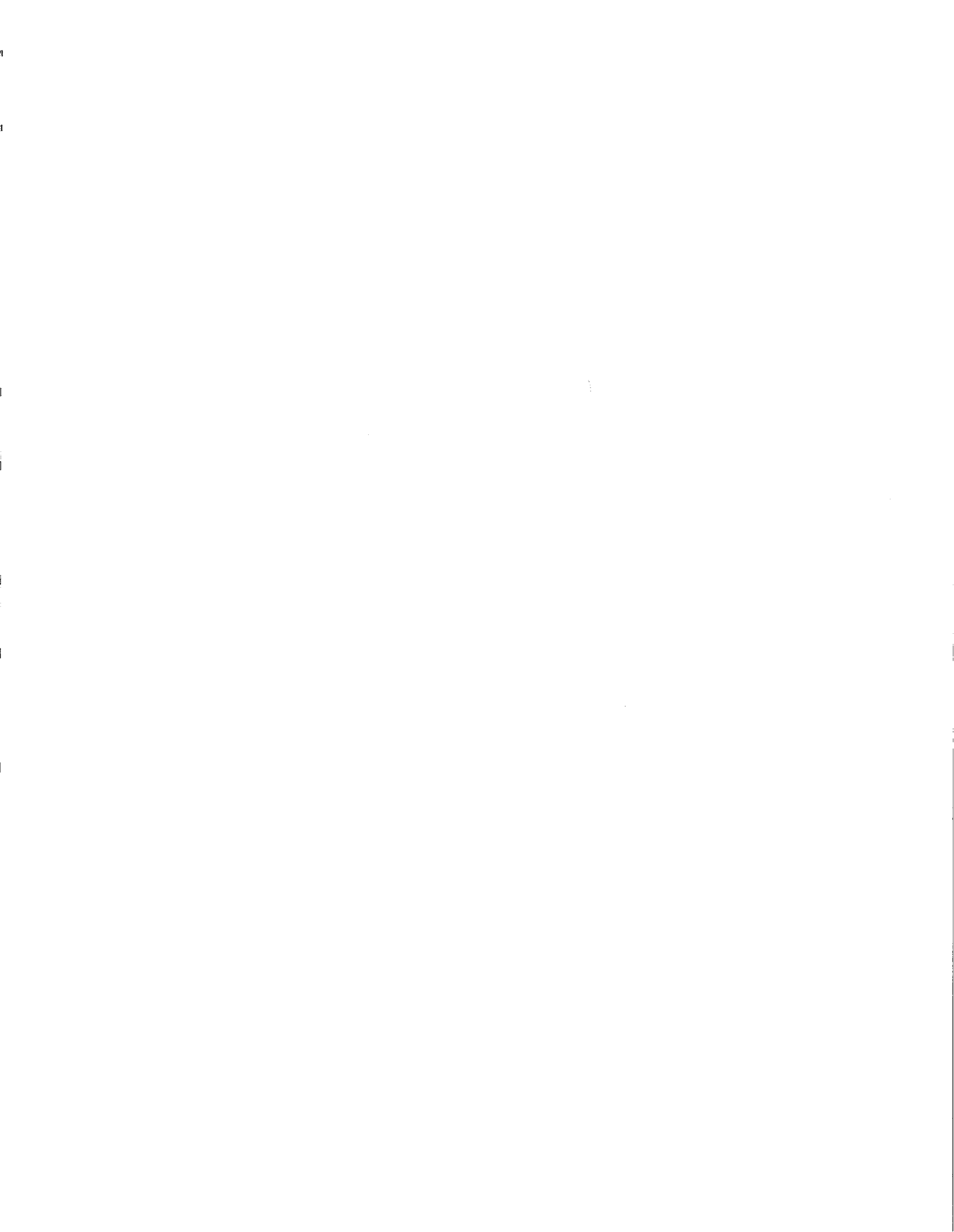
Of the 25 discounts State agencies took advantage of, 13 were discounts off the list price and 12 were prompt payment discounts. Agencies satisfied the terms of prompt payment discounts in nine cases. None of these discounts were the type that required the agency to pay within 10 days. Most required payment by the 10th of the month following the month of purchase.

In three cases, however, the University of Kansas took discounts even though it failed to meet the discount terms. University officials said they commonly take advantage of discounts offered by vendors regardless of whether the vendor's terms are satisfied. According to those officials, many vendors have an informal understanding with the University that they will allow this practice. If a vendor objects, the University refunds the discount. University officials said few vendors had complained or requested such refunds.

With the exception of the Medical Center, all the agencies visited by the auditors reported following a similar practice. Officials of the Division of Purchases and the Division of Accounts and Reports said that this was the usual practice for State agencies, and that they did not consider it improper as long as the agency refunded any discount it had not earned upon the vendor's request, as called for in the Prompt Payment Act, K.S.A. 75-6405.

Conclusion

Although some discount opportunities are being lost by State agencies, the magnitude of these losses does not appear to be significant overall. The discounts lost tend to be prompt payment discounts for which the agency failed to meet the payment deadline.



APPENDIX A

Discounts Agencies Took Advantage Of

<u>Agency</u>	<u>Discount Terms</u>	<u>Compliance Wth Terms^(a)</u>	<u>Amount of Discount</u>
Dept. of Administration	49% off list price	Not applicable	\$668.24
Dept. of Administration	10% off list price	Not applicable	.40
Dept. of Corrections	10% off list price	Not applicable	47.41
Dept. of Corrections	6% off list price	Not applicable	6.13
University of Kansas	42% off list price	Not applicable	2,266.99
University of Kansas	10% off list price	Not applicable	4.03
University of Kansas	10% off list price	Not applicable	4.02
KU Medical Center	20% off list price	Not applicable	15.96
Dept. of SRS	10% off list price	Not applicable	1.38
Dept. of SRS	10% off list price	Not applicable	2.49
Dept. of Transportation	25% off list price	Not applicable	2.21
Dept. of Transportation	49% off list price	Not applicable	121.44
Dept. of Transportation	40, 48, and 49% off list price	Not applicable	2,724.33
Dept. of Administration	2% within 20 days	Terms met	14.06
Dept. of Administration	2% by 10th of following month	Terms met	4.47
Dept. of Administration	2% by 10th of following month	Terms met	61.48
Dept. of Corrections	2%/20% by 10th of following mo.	Terms met	19.08
University of Kansas	2% by 10th of following month	Terms met	3.59
University of Kansas	2% by 10th of following month	Terms met	.89
KU Medical Center	2% by 10th of following month	Terms met	57.60
Dept. of SRS	2% by 10th of following month	Terms met	33.96
Dept. of Transportation	2% by 10th of following month	Terms met	8.05
University of Kansas	1% within 10 days	8 days past deadline	.32
University of Kansas	1% within 10 days	57 days past deadline	4.33
University of Kansas	2% by 10th of following month	1 day past deadline	<u>49.17</u>
Total			\$6,122.03

(a) To determine whether agencies complied with the terms of a discount, the auditors counted the number of days from the date the goods or invoice was received (whichever was later) to the date the warrant was issued. If the date the goods or invoice was received was not available, the auditors counted from the invoice date.

APPENDIX B

Agency Response

On April 14, 1988, a copy of the draft audit report was sent to the Department of Administration for review and comment. The Department's written response is included in this appendix.

STATE OF KANSAS



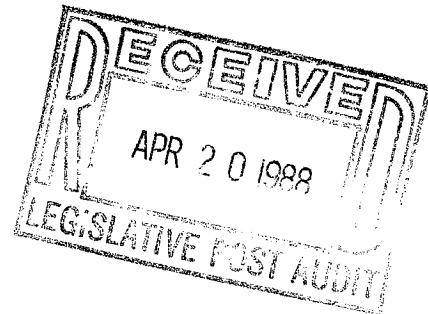
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H. Edward Flentje, *Secretary*

April 19, 1988

Meredith Williams
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Dear Mr. Williams:

I am in receipt of the draft "Vendor Discounts to State Agencies" report. I have no corrections or clarifications regarding its contents. Generally, I was pleased with the high frequency with which state agencies took advantage of vendor discounts.

Thank you for the opportunity to comment on the draft of the report.

Sincerely,

A handwritten signature in cursive script, appearing to read "H. Edward Flentje".

H. Edward Flentje
Secretary of Administration

HEF:dp
5442A

