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NEWS RELEASE

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Auditor of State David A. Vaudt today released a report on Wave 2 of the Phase II Strategic Sourcing Initiative implemented by the Department of Administrative Services (DAS). DAS implemented the Initiative with assistance from A.T. Kearney, a management consulting firm. The assistance was provided as a result of a multi-phased contract process. Strategic Sourcing is defined by A.T. Kearney as a “disciplined, systematic process for approaching the supply market” or a “defined process designed to reduce the total costs of externally purchased material, goods and services while maintaining or improving the level of quality, service and technology.” Vaudt issued a report on Wave 1 of the Initiative on July 24, 2007.

Wave 2 of the Initiative was undertaken with the intent of revising sourcing approaches in order to generate significant savings for the 4 participating state agencies when purchasing goods and services and improving procurement processes and practices. In addition to DAS, the Department of Transportation, the Department of Corrections and the Iowa Veteran’s Home chose to participate in Wave 2. To begin the Strategic Sourcing efforts for Wave 2, categories of purchases and their related addressable spend which were considered viable for improvements in pricing, processes and practices were identified. Targeted savings and targeted savings percentages were also identified for each sourcing category.

As with Wave 1 of the Initiative, DAS requested the Office of the Auditor of State review the sourcing categories under Wave 2 of the Initiative to determine if the addressable spend and savings identified by A.T. Kearney could be validated. For those Wave 2 sourcing categories where savings could be validated, first year savings of \$50,325, an average of less than 1% of the \$17,921,651 of addressable spend, was validated. The validated savings represent potential savings the State could achieve as a result of Wave 2 of the Initiative if certain assumptions are met. A.T. Kearney was paid \$882,260 for its services under Wave 2.

The addressable spend amounts included in the Fourth Amendment to the contract between DAS and A.T. Kearney (Fourth Amendment), the close-out reports from A.T. Kearney and the validated amount for each sourcing category are summarized below. As illustrated below, the addressable spend reported by A.T. Kearney in the close-out reports was less than the amount identified in the Fourth Amendment. We were able to validate \$17,921,651 of the addressable spend reported.

<b>Sourcing Categories per Close-out Report</b>	<b>Fourth Amendment of ATK Contract</b>	<b>Reported by A.T. Kearney</b>	<b>Validated</b>
Construction	\$ 6,000,000	4,609,792	4,609,792
Pharmaceuticals	2,912,319	4,752,296	3,704,590
IT Hardware	6,497,798	519,264	-
Personal Computers (PCs)	233,257	926,000	208,004
Small Package Express Delivery	367,263	491,145	480,604
Salt	10,514,768	12,305,674	8,870,325
Office Furniture	180,272	539,107	-
Maintenance Services	2,484,635	48,336	48,336
<b>Total</b>	<b>\$ 29,190,312</b>	<b>24,191,614</b>	<b>17,921,651</b>

The targeted savings and targeted savings percentages included in the Fourth Amendment, the calculated targeted savings using the validated addressable spend and targeted savings percentages, the actual savings reported by A.T. Kearney in the close-out reports and the validated actual savings for each sourcing category are summarized below.

<b>Sourcing Categories per Close-out Report</b>	<b>Targeted Savings per Fourth Amendment of ATK Contract</b>		<b>Calculated Targeted Savings</b>	<b>Actual Savings Reported by A.T. Kearney</b>	<b>Validated Actual Savings</b>
Construction	\$ 360,000	6%	276,588	653,432	-
Pharmaceuticals	174,739	6	222,275	298,000	-
IT Hardware	519,824	8	**	134,159	-
Personal Computers (PCs)	9,330	4	8,320	319,388	50,028
Small Package Express Delivery	55,090	15	72,091	6,757	297
Salt ^	315,443	3	266,110	-	-
Office Furniture	18,027	10	**	140,688	-
Maintenance Services ^	124,232	5	2,417	-	-
<b>Total</b>	<b>\$ 1,576,685</b>	<b>5%</b>	<b>847,801</b>	<b>1,552,424</b>	<b>50,325</b>

^ - A.T. Kearney reported price increases for both the Salt and Maintenance Services sourcing categories.

\*\* - Addressable spend was not validated for the IT Hardware and Office Furniture sourcing categories; therefore, we are unable to determine calculated targeted savings.

The validated actual savings of \$50,325 shown above is 3.2% of the targeted savings of \$1,576,685 included in the Fourth Amendment and 5.9% of the calculated targeted savings of \$847,801. Actual savings, defined in the Fourth Amendment, is an estimated amount and does

not represent realized savings. The estimated amount could potentially be achieved if certain assumptions are met. However, there is no assurance the estimated amount will be realized.

The Fourth Amendment included both a set fee component and a performance-based component. The set fees of \$882,260 were to be paid in 4 monthly installments and were not based on milestone completion dates. The Fourth Amendment was signed on November 27, 2006 and A.T. Kearney had received the \$882,260 in set fees for Wave 2 by February 19, 2007, despite the extension of the duration of the contract between DAS and A.T. Kearney until September 1, 2007. Because validated actual savings did not meet or exceed at least 50% of the targeted savings identified in the Fourth Amendment, A.T. Kearney did not receive any of the \$224,700 performance-based compensation allowable under the Fourth Amendment.

The report includes calculated statewide and future savings which may result from Wave 2 of the Phase II Strategic Sourcing Initiative if certain assumptions are met. The additional savings calculated do not represent validated actual savings and there is no assurance the estimated savings will be realized. For the newly negotiated contracts implemented as a result of Wave 2 of the Initiative, calculated statewide savings (first-year savings for all State agencies) total \$286,216 and calculated future savings (for the duration of the newly negotiated contracts) total \$571,140.

The report also includes items for consideration by DAS in the administration of the Strategic Sourcing Initiative.

A copy of the report is available for review in the Office of Auditor of State and on the Auditor of State's web site at <http://auditor.iowa.gov/specials/specials.htm>.

# # #



**A REVIEW OF WAVE 2 OF THE  
STRATEGIC SOURCING INITIATIVE  
ADMINISTERED BY THE  
DEPARTMENT OF ADMINISTRATIVE SERVICES**



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To Mollie Anderson, Director of the  
Department of Administrative Services:

We have performed certain agreed-upon procedures to satisfy the "Independent Audit" required by section 6.5.2 of the Fourth Amendment to the contract the Department of Administrative Services (DAS) entered into with A.T. Kearney in 2006 for Strategic Sourcing Services (Fourth Amendment). The procedures were designed to verify and validate the actual contracted annualized savings (actual savings) identified for the 4 participating agencies in Wave 2 of the Phase II Strategic Sourcing Initiative based on information provided to us. To achieve this objective, we performed the following:

- (1) Reviewed the A.T. Kearney contract and the Fourth Amendment to determine the sourcing categories, related addressable spend, target contracted annualized savings (targeted savings) and targeted savings percentages.
- (2) Interviewed individuals responsible for administering Strategic Sourcing to develop an understanding of the process used for each sourcing category, including data sources and methodologies used in developing addressable spend and savings calculations.
- (3) Reviewed the sourcing category close-out reports prepared by A.T. Kearney and related supporting documentation to determine the addressable spend and actual savings to be validated for each sourcing category.
- (4) Reviewed and evaluated the methodologies used by A.T. Kearney to analyze the addressable spend and savings calculations for reasonableness and consistency.
- (5) Tested relevant supporting documentation provided by DAS, A.T. Kearney and/or the category sourcing team members for addressable spend or procurement data to determine whether the amount presented could be validated.
- (6) Recalculated the addressable spend presented by A.T. Kearney in the sourcing category close-out reports by obtaining existing contracts and contract prices.
- (7) Determined calculated targeted savings for each sourcing category using the targeted savings percentage and the validated addressable spend.
- (8) Reviewed newly negotiated contracts and contract prices for each sourcing category, including reasonableness of the Request for Proposal process, to be used in the calculation of actual savings.
- (9) Recalculated the actual savings reported by A.T. Kearney in the sourcing category close-out reports, using the addressable spend and existing and renegotiated contract prices to determine whether the amount presented could be validated.
- (10) Compared the validated actual savings with the greater of the targeted savings or the calculated targeted savings using the targeted savings percentage to determine whether targeted savings were achieved.

Based on these procedures, we were able to validate \$17,921,651 of the \$24,191,614 addressable spend and \$50,325 of the \$1,552,424 actual savings presented by A.T. Kearney in the sourcing category close-out reports. Both the addressable spend and actual savings A.T. Kearney presented for validation were less than the addressable spend and targeted savings included in the Fourth Amendment. In addition, the validated actual savings of \$50,325 is 3.2% of the targeted savings of \$1,576,685 included in the Fourth Amendment and 5.9% of the calculated targeted savings of \$847,801. Actual savings, defined in the Fourth Amendment, is an estimated amount and does not represent realized savings. The estimated amount could potentially be achieved if certain assumptions are met. However, there is no assurance the estimated amount will be realized.

The procedures described above do not constitute an audit of financial statements conducted in accordance with U.S. generally accepted auditing standards. Had we performed additional procedures, or had we performed an audit of the Department of Administrative Services, other matters might have come to our attention that would have been reported to you.

We would like to acknowledge the assistance and many courtesies extended to us by the officials and personnel of the Department of Administrative Services and A.T. Kearney throughout the engagement.



DAVID A. VAUDT, CPA  
Auditor of State



WARREN G. JENKINS, CPA  
Chief Deputy Auditor of State

April 8, 2008

## **Executive Summary**

In 2005, representatives of the Department of Administrative Services (DAS) implemented a Strategic Sourcing Initiative with assistance from A.T. Kearney, a management consulting firm. Strategic Sourcing is defined as a “disciplined, systematic process for approaching the supply market” or a “defined process designed to reduce the total costs of externally purchased material, goods and services while maintaining or improving the level of quality, service and technology.” The contract with A.T. Kearney (ATK Contract) was divided into multiple phases and waves. The Office of the Auditor of State completed a review of Phase II, Wave 1 on July 24, 2007.

The Fourth Amendment to the ATK Contract (Fourth Amendment), signed November 27, 2006, began Phase II, Wave 2, which is the subject of this review. In addition to DAS, the Department of Transportation, the Department of Corrections and the Iowa Veteran’s Home chose to participate in Wave 2.

The Fourth Amendment required an independent audit and validation of actual contracted annualized savings (actual savings) identified as a result of Wave 2 of the Strategic Sourcing Initiative. Actual savings was specifically defined in the contract between DAS and A.T. Kearney. Actual savings is an estimated amount and does not represent realized savings. The estimated amount could potentially be achieved if certain assumptions are met. However, there is no assurance the estimated amount will be realized. A component of the savings calculation is addressable spend or the population of purchases to which the savings is applied. The following paragraphs summarize the results of the procedures performed to validate the addressable spend and actual savings reported by A.T. Kearney.

**Addressable Spend** – The following **Table** summarizes the addressable spend amounts included in the Fourth Amendment, the close-out reports from A.T. Kearney and the validated amount for each sourcing category. The addressable spend for each sourcing category is discussed further in the “Strategic Sourcing Categories” section of this report.

<b>Sourcing Categories per Close-out Report</b>	<b>Fourth Amendment</b>	<b>Reported by A.T. Kearney</b>	<b>Validated</b>
Construction	\$ 6,000,000	4,609,792	4,609,792
Pharmaceuticals	2,912,319	4,752,296	3,704,590
IT Hardware	6,497,798	519,264	-
Personal Computers (PCs)	233,257	926,000	208,004
Small Package Express Delivery	367,263	491,145	480,604
Salt	10,514,768	12,305,674	8,870,325
Office Furniture	180,272	539,107	-
Maintenance Services	2,484,635	48,336	48,336
Total	\$ 29,190,312	24,191,614	17,921,651

The addressable spend included in the Fourth Amendment is significantly higher than the addressable spend A.T. Kearney reported in the close-out reports for the Construction, IT Hardware and Maintenance Services sourcing categories. The decreases in addressable spend are a result of the decision to limit sourcing strategies to roofing projects within the Construction sourcing category, servers and printers within the IT Hardware sourcing category and specific service locations for the Maintenance Services sourcing category.

## A Review of the Strategic Sourcing Initiative

For the Pharmaceuticals, PCs and Office Furniture sourcing categories, the addressable spend included in the Fourth Amendment is significantly less than the addressable spend A.T. Kearney reported in the close-out reports for each sourcing category. The changes resulted from A.T. Kearney's addressable spend calculation strategy for the Pharmaceuticals and PCs sourcing categories and the use of a one-time large-scale procurement for the Office Furniture sourcing category.

**Savings** – The following **Table** summarizes the target contracted annualized savings (targeted savings) and targeted savings percentages included in the Fourth Amendment, the calculated targeted savings using the validated addressable spend and targeted savings percentage, the actual savings reported by A.T. Kearney in the close-out reports and the validated actual savings for each sourcing category. The savings for each sourcing category is discussed further in the “Strategic Sourcing Categories” section of this report.

Sourcing Categories per Close-out Report	Targeted Savings Per Fourth Amendment		Calculated Targeted Savings	Actual Savings Reported by A.T. Kearney	Validated Actual Savings
Construction	\$ 360,000	6%	276,588	653,432	-
Pharmaceuticals	174,739	6	222,275	298,000	-
IT Hardware	519,824	8	**	134,159	-
Personal Computers (PCs)	9,330	4	8,320	319,388	50,028
Small Package Express Delivery	55,090	15	72,091	6,757	297
Salt ^	315,443	3	266,110	-	-
Office Furniture	18,027	10	**	140,688	-
Maintenance Services ^	124,232	5	2,417	-	-
<b>Total</b>	<b>\$ 1,576,685</b>	<b>5%</b>	<b>847,801</b>	<b>1,552,424</b>	<b>50,325</b>

^ - A.T. Kearney reported price increases for both the Salt and Maintenance Services sourcing categories.

\*\* - Addressable spend was not validated for the IT Hardware and Office Furniture sourcing categories; therefore, we are unable to determine calculated targeted savings.

The targeted savings included in the Fourth Amendment is significantly higher than the actual savings A.T. Kearney reported in the close-out reports for the IT Hardware, Small Package Express Delivery, Salt and Maintenance Services sourcing categories. As stated previously, sourcing strategies for the IT Hardware sourcing category were limited to servers and printers. For the Small Package Express Delivery sourcing category, DAS chose to pursue a multi-state consortium contract which was not included in the Initiative. Both the Salt and Maintenance Services sourcing categories resulted in price increases; therefore, A.T. Kearney did not report actual savings in the close-out reports for those sourcing categories.

For the Construction, PCs and Office Furniture sourcing categories, the targeted savings included in the Fourth Amendment is significantly less than the actual savings A.T. Kearney reported in the sourcing category close-out reports. Although the addressable spend was reduced for the Construction sourcing category, A.T. Kearney still reported significant savings as a result of the calculation used to arrive at the actual savings amount. For the PCs sourcing category, the increase to the actual savings reported correlates to the increase in the addressable spend A.T. Kearney reported. As stated previously, the increase in the actual savings reported for the Office Furniture sourcing category is primarily due to the use of a one-time large-scale procurement as the basis for addressable spend.

### **Actual Savings as a Percentage of Targeted Savings**

The Fourth Amendment included both a set fee component and a performance-based component. The set fees of \$882,260 were to be paid in 4 monthly installments and were not based on milestone completion dates. The Fourth Amendment was signed on November 27, 2006 and A.T. Kearney had received all set fees for Wave 2 by February 19, 2007, despite the extension of the duration of the ATK Contract until September 1, 2007.

In accordance with the Fourth Amendment, the final payment to A.T. Kearney is subject to performance evaluation. The final payment could be as much as \$224,700, depending upon the actual savings validated. Because validated actual savings did not meet or exceed at least 50% of the targeted savings identified in the Fourth Amendment, A.T. Kearney did not receive any of the \$224,700 performance-based compensation.

### **Calculated Savings**

In addition to the actual savings reported for the 4 participating state agencies, A.T. Kearney also included a calculation of statewide savings in several sourcing category close-out reports. The statewide savings represent amounts which may be achieved provided certain assumptions are met. The additional savings calculated do not represent validated or realized savings, and there is no assurance the calculated amounts will be realized. DAS also requested the Office of Auditor of State calculate a future savings amount based on the duration of the newly negotiated contracts and validated actual savings. For those Wave 2 sourcing categories where savings could be validated, calculated statewide savings (first-year savings for all state agencies) total \$286,216 and calculated future savings (for the duration of the newly negotiated contracts) total \$571,140.

### **Items for Further Consideration**

This report also includes items for further consideration in the administration of the Strategic Sourcing Initiative, implementation of sourcing strategies and potential future contractual relationships with consulting firms in similar savings initiatives.

In addition, as previously stated, actual savings is an estimated savings amount and does not represent realized savings. Because the actual savings validated in this report is an estimated amount which could potentially be achieved if certain assumptions are met, consideration should be given to validation or review of the realized savings achieved by the end of fiscal year 2008 or 2009. The fiscal year to be reviewed would depend on the effective date of the contracts implemented for each sourcing category. This validation or review would use actual purchase information rather than historical or projected information.

## **Strategic Sourcing Initiative**

In 2005, representatives of the Department of Administrative Services (DAS) implemented a Strategic Sourcing Initiative with assistance from A.T. Kearney, a management consulting firm. The assistance was provided as a result of a multi-phased contract process. A.T. Kearney defined Strategic Sourcing as a “disciplined, systematic process for approaching the supply market” or a “defined process designed to reduce the total costs of externally purchased material, goods and services while maintaining or improving the level of quality, service and technology.” A.T. Kearney was to provide specific services within each Phase of the contract. The following four principles were identified by A.T. Kearney as Strategic Sourcing components:

- (1) Understand and define the total value of the relationship between the State and the supplier.
- (2) Develop solutions based on a deep understanding of suppliers’ economics and business dynamics.
- (3) Apply new tools and techniques to optimize the supplier relationships and maximize savings.
- (4) Embed the required changes in the organization so the State can continuously improve.

### **PHASE I CONTRACT**

In March 2005, DAS contracted with A.T. Kearney for the provision of Phase I Strategic Sourcing Services. Phase I was defined as an opportunity assessment during which A.T. Kearney reviewed the purchasing practices of the State, extracted and analyzed preliminary spend data and planned the implementation of Strategic Sourcing within the State, including identification of the sourcing categories. According to an Innovations Fund loan application filed with the Department of Management (DOM), A.T. Kearney identified addressable spend of at least \$750 million, with targeted savings ranging from \$34 million to \$98 million. A.T. Kearney received compensation of \$192,500 for Phase I of the Initiative.

### **PHASE II, WAVE 1 CONTRACT**

In October 2005, DAS entered into a contract with A.T. Kearney (ATK Contract) for Phase II of the Strategic Sourcing Initiative. According to the ATK Contract, Phase II was divided into 3 Waves. The ATK Contract established in October 2005 was for Wave 1. The duration of the ATK Contract was established as July 1, 2005 through February 29, 2006 and was later extended through October 31, 2006. According to a representative of DAS, Wave 3 will not be pursued.

For Wave 1, A.T. Kearney estimated addressable spend and target contracted annualized savings (targeted savings) for 10 sourcing categories to be \$210.9 million and \$10.6 million, respectively. According to the ATK Contract, addressable spend is defined, in part, as “the proportion of expenditures by the State in a given category that DAS, Independent Purchasing Authorities and other Participating Departments or Agencies agree are considered viable for a strategic sourcing initiative.” Targeted savings is defined, in part, as “the amount of savings projected by the Contractor as the amount which can be saved.” **Appendix A** includes definitions of the terms used in this report. During evaluation of the sourcing categories, DAS made several amendments to the requirements of the ATK Contract, reducing addressable spend and targeted savings for Wave 1 to \$62.7 million and \$3.4 million, respectively. DAS did not adjust the compensation awarded to A.T. Kearney in conjunction with the reduction to targeted savings.

In accordance with the provisions of the ATK Contract, DAS requested a performance evaluation to determine the independently audited actual contracted annualized savings (actual savings) achieved as a result of Wave 1. Actual savings is defined in the ATK Contract, in part, as the “accumulation of dollars as determined through the “Savings Calculations.” (**Appendix A** includes the complete definition.) Actual savings is an estimated

**A Review of the Strategic Sourcing Initiative**

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savings amount and does not represent realized savings. The estimated amount could potentially be achieved if certain assumptions are met. However, there is no assurance the estimated amount will be realized.

The Office of Auditor of State issued a report on Phase II, Wave 1 on July 24, 2007 in which validated addressable spend and actual savings were \$46.7 million and \$2.9 million, respectively. As a result of the ATK Contract amendments to targeted savings, A.T. Kearney achieved at least 80% of targeted savings per the final ATK Contract amendment, which qualified them for receipt of the full Wave 1 performance-based portion of compensation in the amount of \$766,000, in addition to set fees of \$2.7 million.

**PHASE II, WAVE 2 CONTRACT**

In November 2006, DAS signed the Fourth Amendment to the ATK Contract (Fourth Amendment) for Wave 2 of Phase II of the Strategic Sourcing Initiative, which extended the duration of the Initiative through March 1, 2007. The Fifth Amendment to the ATK Contract, signed April 2, 2007, extended the duration of the Initiative through September 1, 2007.

**Objective** - The ATK Contract was established to achieve significant savings in the sourcing categories identified during the opportunity assessment conducted by A.T. Kearney representatives during Phase I of the Strategic Sourcing Initiative. The goals of each Wave of Phase II included revising sourcing approaches in order to generate significant savings and improving procurement processes and practices. These goals were to be accomplished through analysis of the State’s spending and use of more effective sourcing and business practices.

Each of the sourcing categories specified in the Fourth Amendment included addressable spend, targeted savings and targeted savings percentages. The sourcing categories identified in the Fourth Amendment for Wave 2, the related addressable spend, targeted savings and targeted savings percentages are listed by sourcing category in **Table 1**. As illustrated by the **Table**, total targeted savings included in the Fourth Amendment for Wave 2 is \$1,576,685. Addressable spend was based on fiscal year 2006 data obtained from the State.

**Table 1**

<b>Sourcing Category</b>	<b>Addressable Spend</b>	<b>Targeted Savings</b>	<b>Targeted Savings Percentage</b>
Construction	\$ 6,000,000	360,000	6%
Pharmaceuticals	2,912,319	174,739	6
IT Hardware	6,497,798	519,824	8
Personal Computers (PCs)	233,257	9,330	4
Small Package Express Delivery	367,263	55,090	15
Salt	10,514,768	315,443	3
Office Furniture	180,272	18,027	10
Maintenance Services	2,484,635	124,232	5
Grand Total	\$ 29,190,312	1,576,685	5%

In accordance with the ATK Contract, the services to be performed by A.T. Kearney included development of trustful long-term relationships with the State’s suppliers, transfer of knowledge to State staff through formal training and coaching and organization of the strategic sourcing project into 3 major Work Streams of Program Management, Process Improvement and Strategic Sourcing. (**Appendix A** includes the definition of Work Streams.)

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**A Review of the Strategic Sourcing Initiative**

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In addition, A.T. Kearney was to develop and recommend revised sourcing approaches to generate substantial savings and improvements to procurement processes and practices. This was to be accomplished by completing a thorough analysis of the State's spending and the use of more effective sourcing and business practices.

**Cost of the Contract** – The Fourth Amendment included both a set fee component and a performance-based component. The set fees of \$882,260 were to be paid in 4 monthly installments and were not based on milestone completion dates. **Table 2** summarizes the payment schedule included in the Fourth Amendment and the dates A.T. Kearney received each payment. By February 19, 2007, A.T. Kearney had received all set fees for Wave 2, despite the extension of the duration of the ATK Contract until September 1, 2007.

**Table 2**

<b>Invoice Date</b>	<b>Date Paid</b>	<b>Amount</b>
November 30, 2006	December 27, 2006	\$ 272,360
December 22, 2006	December 29, 2006	203,300
January 21, 2007	February 8, 2007	203,300
February 16, 2007	February 19, 2007	203,300
Total		\$ 882,260

An additional final payment of \$224,700 was subject to performance evaluation. As established by the Fourth Amendment, the performance-based compensation is dependent upon the independently audited actual savings achieved as a result of the Initiative, expressed as a percentage of the targeted savings. The Fourth Amendment established the following 3 compensation levels based on the performance level achieved.

- (1) For actual savings less than 50% of targeted savings, A.T. Kearney was not to receive any compensation in addition to the set fee.
- (2) For actual savings greater than 50% but less than 80% of targeted savings, A.T. Kearney was to receive \$112,350 (50% of the performance-based compensation).
- (3) For actual savings greater than 80% of targeted savings, A.T. Kearney was to be paid the full \$224,700.

By February 19, 2007, A.T. Kearney had received total payments of \$882,260, consisting of all set fees in accordance with the Fourth Amendment. Because validated actual savings did not meet or exceed at least 50% of the targeted savings identified in the Fourth Amendment, A.T. Kearney did not receive any of the \$224,700 performance-based compensation.

**Funding Sources** - Various funding sources have been used to finance the Strategic Sourcing Initiative. As of March 31, 2008, the account within the State's accounting system used to track the Strategic Sourcing Initiative included revenues totaling \$6,616,614.68. Of that amount, \$2.3 million was from an Innovations Fund loan received through DOM and \$4,316,614.68 was from State agency billings provided for by Strategic Sourcing Memorandums of Understanding (MOUs).

State agency payments totaled \$2,472,994.33 during fiscal years 2005 and 2006 prior to Wave 2 of the Initiative and \$1,385,988.41 and \$457,631.94 during fiscal years 2007 and 2008, respectively. **Schedule 1** summarizes the payments by State agency for fiscal years 2005 through 2008. These payments will be used by DAS to repay the Innovations Fund loan, including interest, to pay the fees charged by A.T. Kearney and to pay audit costs. DAS also reduced several State agencies' cash balances within the Vehicle Depreciation Fund for Phase II, Wave 1 in relation to the Fleet sourcing category. However, there was no such reduction for Phase II, Wave 2.

**A Review of the Strategic Sourcing Initiative**

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At the beginning of Wave 2, DAS requested 3 State agencies participate in the Initiative and complete an MOU to document their support. By completing the MOUs, the 3 State agencies agreed to pay DAS the amount specified in the fee payment schedule attached to the MOUs. The 3 State agencies, in addition to DAS, who agreed to participate in Wave 2 of the Initiative are the Department of Transportation (DOT), the Department of Corrections (DOC) and the Iowa Veteran’s Home (IVH). **Table 3** summarizes scheduled payments for fiscal years 2007 through 2010 for the 4 State agencies participating in Wave 2 of the Initiative. According to a DAS representative, because A.T. Kearney will not receive the performance-based compensation, the participating agencies’ payment schedules will be adjusted.

**Table 3**

Department/ State Agency	Fiscal Year				Total
	2007	2008	2009	2010	
DOC	\$ 50,000	100,000	100,000	50,000	300,000
DAS	74,389	148,778	148,778	74,389	446,334
DOT	74,389	148,778	148,778	74,389	446,334
IVH	3,750	7,500	7,500	3,750	22,500
Total	\$ 202,528	405,056	405,056	202,528	1,215,168

**Reports from A.T. Kearney** – As the work was completed for each sourcing category included in **Table 1**, A.T. Kearney completed a sourcing category close-out report which included the addressable spend and actual savings identified and a brief description of the methodology and process used to determine the amounts.

**Provision for Independent Audit** – The Fourth Amendment required an independent audit be conducted by an outside auditing entity upon completion of Wave 2 services. The Fourth Amendment required the audit to review and validate the actual savings to be used in determining performance-based compensation.

In order to validate the actual savings, it was necessary to consider the revised sourcing approaches used by DAS and A.T. Kearney, process improvements and the Strategic Sourcing Work Stream, which included category and supplier profiling, sourcing strategy formulation, analysis and negotiation support, implementation and integration planning. The results of these services performed by A.T. Kearney were documented in the sourcing category close-out reports for validation.

Our review was conducted to satisfy the “Independent Audit” required by section 6.5.2 of the Fourth Amendment DAS entered into with A.T. Kearney in 2006 for Strategic Sourcing Services. The procedures performed are summarized in the Independent Auditor’s Report. The primary objective of the review was to validate addressable spend and actual savings reported by A.T. Kearney in the close-out reports for each sourcing category.

During the course of our fieldwork, we issued preliminary reports for 5 of the 8 sourcing categories. The purpose of the preliminary reports was to provide validated addressable spend and actual savings amounts to DAS to allow for timely payment of the performance-based compensation to A.T. Kearney. The remaining 3 sourcing categories each had pending issues which were not resolved until preparation of this report had begun; therefore, preliminary reports were not considered necessary. This final, comprehensive report expands upon the preliminary report results. Specifically, this report addresses the methodologies used for each sourcing category, the documentation and calculations used to arrive at addressable spend and actual savings and other aspects of Strategic Sourcing relevant to the validation process.

## Summary of Results

The following paragraphs summarize the results of our validation of the addressable spend and actual savings reported by A.T. Kearney in the close-out reports for each sourcing category.

### Addressable Spend

**Table 4** summarizes the addressable spend amounts included in the Fourth Amendment, the close-out reports from A.T. Kearney and the validated amount for each sourcing category. The addressable spend for each sourcing category is discussed further in the “Strategic Sourcing Categories” section of this report starting on the page shown in the **Table**.

**Table 4**

Sourcing Categories	Page	Fourth Amendment	Reported by A.T. Kearney	Validated
Construction	14	\$ 6,000,000	4,609,792	4,609,792
Pharmaceuticals	15	2,912,319	4,752,296	3,704,590
IT Hardware	20	6,497,798	519,264	-
Personal Computers (PCs)	22	233,257	926,000	208,004
Small Package Express Delivery	26	367,263	491,145	480,604
Salt	28	10,514,768	12,305,674	8,870,325
Office Furniture	30	180,272	539,107	-
Maintenance Services	33	2,484,635	48,336	48,336
Total		\$ 29,190,312	24,191,614	17,921,651

The addressable spend included in the Fourth Amendment is significantly higher than the addressable spend A.T. Kearney reported in the close-out reports for the Construction, IT Hardware and Maintenance Services sourcing categories. The decreases in addressable spend are a result of the decision to limit sourcing strategies to roofing projects within the Construction sourcing category, servers and printers within the IT Hardware sourcing category and specific service locations for the Maintenance Services sourcing category.

For the Pharmaceuticals, PCs and Office Furniture sourcing categories, the addressable spend included in the Fourth Amendment is significantly less than the addressable spend A.T. Kearney reported in the close-out reports for each sourcing category. The changes resulted from A.T. Kearney’s addressable spend calculation strategy for the Pharmaceuticals and PCs sourcing categories and the use of a one-time large-scale procurement for the Office Furniture sourcing category.

### Savings

**Table 5** summarizes the targeted savings and targeted savings percentage included in the Fourth Amendment, the calculated targeted savings using the validated addressable spend and targeted savings percentages, the actual savings reported by A.T. Kearney in the close-out reports and the validated actual savings for each sourcing category. The savings for each sourcing category is discussed further in the “Strategic Sourcing Categories” section of this report starting on the page shown in the **Table**.

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**Table 5**

Sourcing Categories	Page	Targeted Savings Per Fourth Amendment	Calculated Targeted Savings	Actual Savings Reported by A.T. Kearney	Validated Actual Savings	
Construction	14	\$ 360,000	6%	276,588	653,432	-
Pharmaceuticals	16	174,739	6	222,275	298,000	-
IT Hardware	21	519,824	8	**	134,159	-
Personal Computers (PCs)	25	9,330	4	8,320	319,388	50,028
Small Package Express Delivery	27	55,090	15	72,091	6,757	297
Salt ^	29	315,443	3	266,110	-	-
Office Furniture	32	18,027	10	**	140,688	-
Maintenance Services ^	33	124,232	5	2,417	-	-
Total		\$ 1,576,685	5%	847,801	1,552,424	50,325

^ - A.T. Kearney reported price increases for both the Salt and Maintenance Services sourcing categories.

\*\* - Addressable spend was not validated for the IT Hardware and Office Furniture sourcing categories; therefore, we are unable to determine calculated targeted savings.

As illustrated by **Table 5**, the Fourth Amendment includes 2 targeted savings components for each sourcing category: a targeted savings amount and a targeted savings percentage. Because 2 targeted savings components are included in the Fourth Amendment, we compared validated actual savings to both the targeted savings amount and a calculated targeted savings using the targeted savings percentage. As shown in **Table 4**, reported addressable spend varies significantly from the Fourth Amendment for several sourcing categories. These changes to addressable spend impact targeted savings, as well. According to DAS representatives, if reported addressable spend increased from the amount included in the Fourth Amendment, the calculated targeted savings should be used to analyze validated actual savings. However, if reported addressable spend decreased, the targeted savings amount included in the Fourth Amendment should be used to analyze validated actual savings.

The targeted savings included in the Fourth Amendment is significantly higher than the actual savings A.T. Kearney reported in the close-out reports for the IT Hardware, Small Package Express Delivery, Salt and Maintenance Services sourcing categories. As stated previously, sourcing strategies for the IT Hardware sourcing category were limited to servers and printers. For the Small Package Express Delivery sourcing category, DAS chose to pursue a multi-state consortium contract which was not included in the Initiative. Both the Salt and Maintenance Services sourcing categories resulted in price increases; therefore, A.T. Kearney did not report actual savings in the close-out reports for those sourcing categories.

For the Construction, PCs and Office Furniture sourcing categories, the targeted savings included in the Fourth Amendment is significantly less than the actual savings A.T. Kearney reported in the sourcing category close-out reports. Although the addressable spend was reduced for the Construction sourcing category, A.T. Kearney still reported significant savings as a result of the calculation used to arrive at the actual savings amount. For the PCs sourcing category, the increase to the actual savings reported correlates to the increase in the addressable spend A.T. Kearney reported. As stated previously, the increase in the actual savings reported for the Office Furniture sourcing category is primarily due to the use of a one-time large-scale procurement as the basis for addressable spend.

### Actual Savings as a Percentage of Targeted Savings

At the end of our fieldwork, the validated actual savings of \$50,325 shown in **Table 5** was 3.2% of the targeted savings of \$1,576,685 and 5.9% of the calculated targeted savings of \$847,801. Because validated actual savings did not meet or exceed at least 50% of the targeted savings identified in the Fourth Amendment, A.T. Kearney did not receive any of the \$224,700 performance-based compensation.

## Strategic Sourcing Categories

### CONSTRUCTION

**Addressable Spend** – The Fourth Amendment includes addressable spend of \$6,000,000 for the Construction sourcing category. This amount is based solely on DAS, which is the agency responsible for contracting all construction projects for state agencies. A.T. Kearney reported addressable spend of \$4,609,792 in the sourcing category close-out report, which is \$1,390,208 less than the amount included in the Fourth Amendment. The decrease resulted from the use of different baselines. The Fourth Amendment was based on the assumption roofing construction spend was equal to 70% of the construction costs identified in Wave 1 of the Initiative while the sourcing category close-out report was based on the total design firm estimates for the 28 roofing projects scheduled for fiscal year 2008. We have validated the \$4,609,792 addressable spend reported.

Addressable spend consists of the cost estimates for 28 roofing projects scheduled for completion in fiscal year 2008. The cost estimates for the roofing projects were provided by 4 architectural and engineering design firms. **Table 6** summarizes the number of projects and addressable spend for the Construction sourcing category by design firm.

**Table 6**

Description	Number of Projects	Amount
Genesis Architectural Design	11	\$ 1,843,926
Keffer/Overton Architects	6	1,511,720
Howard R. Green Company	1	950,000
Shive-Hattery, Inc.	10	304,146
Total	28	\$ 4,609,792

**Targeted Savings** – A.T. Kearney’s savings strategy was to group roofing projects by geographical location or design firm into bid packages with phased release dates to benefit from volume discounts rather than bidding each individual roofing project. As a result of this strategy, DAS issued 12 bid packages for the 28 roofing projects included in the Construction sourcing category. After reviewing the vendors’ responses, DAS entered into contracts with 8 contractors.

**Table 7** compares the targeted savings included in the Fourth Amendment, the calculated targeted savings using the validated addressable spend and targeted savings percentage of 6% included in the Fourth Amendment and the validated actual savings for the Construction sourcing category. For comparative purposes, the **Table** also includes the actual savings reported by A.T. Kearney in the Construction close-out report. As illustrated by the **Table**, we were unable to validate actual savings. Therefore, targeted savings and calculated targeted savings included in the Fourth Amendment were not achieved.

**Table 7**

Description	Per Fourth Amendment		Actual Savings Reported in Close-Out Report	Validated Actual Savings
	Targeted Savings	Calculated Targeted Savings		
Savings amount	\$ 360,000	276,588	653,432	-

The actual savings of \$653,432 reported by A.T. Kearney was calculated by comparing the portion of reported addressable spend (the sum of the design firm estimates) attributable to each of the 12 bid packages to the winning bid for that package. However, this comparison is not consistent with the “Savings Calculation” definition included in **Appendix A**, which requires the

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use of historical data for the baseline year. Therefore, we were unable to validate the actual savings reported.

We identified several other issues related to the savings calculation methodology for the Construction sourcing category which also preclude validation of actual savings, as follows:

- The methodology for the Construction sourcing category is not consistent with the other sourcing categories, which are for the provision of a type of commodity or service and not specific projects. The Construction sourcing category actual savings are based on one-time roofing projects and bids submitted do not apply to future roofing projects. Therefore, future savings as a result of the Strategic Sourcing Initiative will not occur for this sourcing category.
- Design firm cost estimates varied significantly depending on the design firm selected. One design firm's estimated costs were consistently lower than the winning bid and other design firms' estimated costs were consistently higher than the winning bid. Therefore, there is no assurance of the relationship between the design firm estimates and winning bids. Historical project costs would provide a more accurate baseline to determine actual savings.
- Cost estimates and contractor bids do not reflect additional costs resulting from change orders typical on construction contracts. However, any changes or additional costs would be reflected in historical project costs. Therefore, as stated previously, historical project costs would provide a more accurate baseline to determine actual savings.

We met with DAS to discuss the reasons we were unable to validate actual savings for the Construction sourcing category. DAS officials stated the savings strategy implemented with the assistance of A.T. Kearney had resulted in significant savings, which would continue with future projects. We discussed alternative methods to calculate actual savings and we agreed to review a comparison of historical roofing project costs, adjusted for inflation, and newly negotiated roofing project costs. This comparison is consistent with the "Savings Calculation" definition included in **Appendix A**. However, DAS was unable to demonstrate savings as a result of its comparison of historical costs and new costs. Therefore, we remain unable to validate actual savings.

### PHARMACEUTICALS

**Addressable Spend** – The Fourth Amendment includes addressable spend of \$2,912,319 for the Pharmaceuticals sourcing category. A.T. Kearney originally reported addressable spend of \$5.28 million in the sourcing category close-out report. However, after receiving follow-up questions, A.T. Kearney amended the amount to \$4,752,296. The amended addressable spend is \$1,839,977 more than the amount included in the Fourth Amendment. The increase resulted from the use of different baselines. The Fourth Amendment was based on DOC expenditures recorded in the State's accounting system while the sourcing category close-out report was based on calculated addressable spend for 5 of DOC's highest cost drug categories using drug usage and drug cost reports. We have validated \$3,704,590 of the addressable spend reported. The \$1,047,706 difference is primarily due to the lack of sufficient supporting documentation for the addressable spend A.T. Kearney calculated using patient usage records.

A.T. Kearney calculated addressable spend based on data provided by DOC's pharmaceutical providers, Iowa Pharmacy and Diamond Pharmacy. Each vendor provided historical costs by drug category and Iowa Pharmacy also provided extensive patient usage records detailing specific dosage information per patient per drug category. The 5 drug categories evaluated included antipsychotics, anticonvulsants, antidepressants, proton pump inhibitors (PPIs) and statins.

Diamond Pharmacy provided 6 months of sales data to support the addressable spend attributable to them. A.T. Kearney determined the 6-month cost of the 5 drug categories included in the analysis and multiplied the total by 2 to calculate a 12-month cost. The calculated 12-month cost of \$1,804,256 became addressable spend for Diamond Pharmacy.

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Addressable spend for Iowa Pharmacy was based on patient usage data and drug cost data provided by the vendor. For example, **Table 8** summarizes A.T. Kearney’s calculation of addressable spend for statins by specific drug. After calculating total cost, A.T. Kearney determined the percentage of total cost each drug represented. This percentage was then used as the baseline of comparison when A.T. Kearney calculated savings for Iowa Pharmacy for each of the 5 drug categories evaluated.

**Table 8**

<b>Description</b>	<b>Cost per Day</b>	<b>Average Days Used</b>	<b>Cost*</b>	<b>Percent of Statin Usage</b>
Lipitor	\$ 2.81	97,673	\$ 274,711.10	96%
Lovastatin	0.28	7	1.98	-
Zocor	1.28	4,016	5,123.49	4
Total		101,696	\$ 279,836.57	100%

\* - Cost per Day multiplied by Average Days Used (differences due to rounding).

We confirmed A.T. Kearney’s calculation for the \$1,804,256 of addressable spend attributable to Diamond Pharmacy. However, we adjusted A.T. Kearney’s calculation for the \$2,948,040 of addressable spend attributable to Iowa Pharmacy. We determined the calculated addressable spend, described in **Table 8**, resulted in significantly higher costs than Iowa Pharmacy reported in their database of total drug expenditures. Total expenditures included in Iowa Pharmacy’s database for the 5 drug categories evaluated were \$1,900,334, which is \$1,047,706 less than A.T. Kearney’s calculated addressable spend. A.T. Kearney was unable to provide sufficient supporting documentation to either explain the difference between the 2 amounts or demonstrate using the patient usage records was more accurate. Therefore, we validated addressable spend of \$1,900,334 for Iowa Pharmacy.

**Table 9** summarizes the components of validated addressable spend for the Pharmaceuticals sourcing category.

**Table 9**

<b>Description</b>	<b>Amount</b>
Diamond Pharmacy	\$ 1,804,256
Iowa Pharmacy	1,900,334
Total	\$ 3,704,590

**Targeted Savings** – DOC elected to pursue drug management initiatives focusing on 5 of the largest drug spend categories. Drug management initiatives include evaluation of current drug usage, identification of areas for possible substitution with the most cost effective drug therapies and implementation of protocols and management processes to change prescribing practices to focus on the most cost effective drug therapies available.

**Table 10** compares the targeted savings included in the Fourth Amendment, the calculated targeted savings using the validated addressable spend and targeted savings percentage of 6% included in the Fourth Amendment and the validated actual savings for the Pharmaceuticals sourcing category. For comparative purposes, the **Table** also includes the actual savings reported by A.T. Kearney in the Pharmaceuticals close-out report. As illustrated by the **Table**, we were unable to validate actual savings. Therefore, targeted savings and calculated targeted savings were not met.

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**Table 10**

Description	Per Fourth Amendment		Actual Savings Reported in Close-Out Report	Validated Actual Savings
	Targeted Savings	Calculated Targeted Savings		
Savings amount	\$ 174,739	222,275	298,000	-

The actual savings of \$298,000 reported by A.T. Kearney was calculated by analyzing drug spend and usage databases for DOC's 2 drug providers, Diamond Pharmacy and Iowa Pharmacy. **Table 11** summarizes the actual savings reported by A.T. Kearney by drug category.

**Table 11**

Description	Amount
Anticonvulsants	\$ -
Antipsychotics	-
Antidepressants	61,000
PPIs	93,000
Statins	144,000
Total	<u>\$ 298,000</u>

A.T. Kearney determined DOC's current drug management of anticonvulsants and antipsychotics appeared to be well managed with no apparent opportunities for significant additional savings. Therefore, A.T. Kearney did not recommend drug management adjustments for those drug categories.

For antidepressants, PPIs and statins, A.T. Kearney recommended adjustments to current drug usage practices to emphasize use of less costly, therapeutically equivalent medications. **Table 12** summarizes both the current and proposed drug usage mixes. Application of the recommended usage percentages results in the actual savings reported by A.T. Kearney due to emphasis on lower cost alternatives.

**Table 12**

Description	Current Usage	Recommended Usage
Antidepressants:		
Sertraline	24%	29
Escitalopram	7	2
Paroxetine	13	4
Fluoxetine	29	34
Citalopram	27	31
Fluvoxamine	-	-
PPIs:		
Prevacid	19	5
Nexium	1	-
Omeprazole	80	95
Statins:		
Lipitor	96	50
Lovastatin	-	20
Simvastatin (Zocor)	4%	30

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To arrive at actual savings for Iowa Pharmacy, A.T. Kearney first calculated the total cost for each of the 5 drug categories evaluated using the recommended drug usage mix summarized in **Table 12**. They then determined the historical cost per day and number of days used for each drug category as shown in **Table 8**. After calculating historical usage costs, A.T. Kearney compared the cost using the recommended drug usage to the cost using the historical drug usage to determine an adjusted addressable spend. The difference between the addressable spend originally calculated by A.T. Kearney and the adjusted addressable spend became the actual savings reported by A.T. Kearney for Iowa Pharmacy purchases.

**Table 13** summarizes the calculation of recommended costs using the statin drug category as an example. When compared to the calculated addressable spend for statins shown in **Table 8**, changing the recommended percentage of usage for each drug requires adjusting the average days used for each drug. The comparison of the adjusted addressable spend shown in **Table 13** to the calculated addressable spend shown in **Table 8** results in actual savings of \$92,160 (\$279,836.57 - \$187,676.57). A.T. Kearney applied this same methodology to all 5 drug categories evaluated using the recommended usage percentages described in **Table 12**. This resulted in total actual savings of \$203,454.06 for all 5 drug categories for Iowa Pharmacy.

**Table 13**

<b>Description</b>	<b>Cost per Day</b>	<b>Adjusted Average Days Used<sup>^</sup></b>	<b>Proposed Cost*</b>	<b>Recommended Percent of Statin Usage</b>
Lipitor	\$ 2.81	50,848	\$ 143,013.22	50%
Lovastatin	0.28	20,339	5,742.44	20
Zocor	1.28	30,509	38,920.91	30
<b>Total</b>		<b>101,696</b>	<b>\$ 187,676.57</b>	<b>100%</b>

<sup>^</sup> - Average Days Used per drug was adjusted based on the recommended percent of usage.  
<sup>\*</sup> - Cost per Day multiplied by Adjusted Average Days Used (differences due to rounding).

Diamond Pharmacy did not have sufficient usage data to perform the same analysis as described for Iowa Pharmacy. Therefore, A.T. Kearney based the actual savings attributable to Diamond Pharmacy on the assumption the actual savings percentage calculated for Iowa Pharmacy for each drug category would be representative of the savings percentage for Diamond Pharmacy. As a result, A.T. Kearney multiplied the actual savings percentage for each drug category calculated for Iowa Pharmacy by Diamond Pharmacy's calculated addressable spend for each drug category. **Table 14** summarizes the calculation of actual savings for Diamond Pharmacy.

**Table 14**

<b>Description</b>	<b>Diamond Pharmacy Calculated Addressable Spend</b>	<b>Iowa Pharmacy Actual Savings Percentage</b>	<b>Diamond Pharmacy Actual Savings<sup>^</sup></b>
Anticonvulsants	\$ 86,947.62	-%	\$ -
Antipsychotics	1,145,114.46	-	-
Antidepressants	292,833.74	**	-
PPIs	121,404.18	36	43,153.39
Statins	157,955.64	33%	52,020.34
<b>Total</b>	<b>\$ 1,804,255.64</b>		<b>\$ 95,173.73</b>

\*\* - A.T. Kearney reported Iowa Pharmacy actual savings of \$61,000, which is a 46% savings. However, they reported no savings opportunities for antidepressants for Diamond Pharmacy.

<sup>^</sup> - Diamond Pharmacy addressable spend multiplied by Iowa Pharmacy savings percentage (differences due to rounding).

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Total actual savings calculated for Iowa Pharmacy and Diamond Pharmacy was \$298,000. However, we were unable to validate the actual savings reported by A.T. Kearney based on unsupported assumptions A.T. Kearney made in developing their recommendations.

For antidepressants, A.T. Kearney stated the recommended changes in the drug usage mix should be implemented over time and only new patients should be considered for treatment with the less expensive drugs. However, they did not evaluate DOC's patient population to determine the volume of new patients treated each year. In addition, A.T. Kearney did not determine how long it would take to transition DOC's population from current prescriptions to new, less expensive prescriptions. As a result, A.T. Kearney was not able to provide documentation to validate the actual savings reported for antidepressants in the sourcing category close-out report. Further, in their recommendation to adjust the drug usage mix for antidepressants, A.T. Kearney recommended a reduction in the use of escitalopram by 5%. However, the study A.T. Kearney used as the basis for this recommendation did not evaluate escitalopram. As a result, we cannot validate actual savings associated with escitalopram.

For statins, A.T. Kearney assumed one-half of DOC's patient population currently using statins required less than a 40% reduction in LDL-C ("bad cholesterol") and, as a result, could be treated with less expensive drugs. However, A.T. Kearney was not able to provide sufficient supporting documentation for this assumption.

For PPIs, an A.T. Kearney representative stated they assumed 95% of DOC's patient population currently using PPIs could be treated with a less expensive drug. According to the A.T. Kearney representative, they assumed 5% of DOC patients would require the most expensive drug. They stated this was a reasonable allowance for the number of patients who might not respond to the less expensive drug. A.T. Kearney was not able to provide sufficient supporting documentation for this assumption.

The recommended mix of drug usage for each category was based on assumptions A.T. Kearney could not adequately support. A.T. Kearney also did not address the specific needs of DOC patients when making recommendations. Although A.T. Kearney reported they used similar state case studies to formulate their recommendations, the recommended drug usage mixes proposed for DOC did not reconcile to the drug usage mixes A.T. Kearney reported for the other states. In addition, DOC stated their specific needs were not comparable to other state facilities because of the atypical health issues faced by prison populations. As a result, we could not validate the actual savings reported in the sourcing category close-out report.

We also identified other concerns related to the savings calculation methodology for the Pharmaceuticals sourcing category which preclude validation of actual savings, as follows:

- In addition to requiring the validation of actual savings, the Fourth Amendment requires the sourcing strategies meet the state agencies' needs for supplies, services and professional services. Relying on unsupported assumptions rather than patient studies specific to DOC as the basis for making recommendations to change the mix of drug usage does not meet the needs of DOC, as required by the Fourth Amendment.
- According to a representative of DOC, DOC medical staff felt A.T. Kearney's recommendations were medically unacceptable and DOC does not intend to implement the recommendations. The DOC representative also stated A.T. Kearney failed to adjust their recommendations to meet the needs of DOC's population and did not consult DOC medical staff during the evaluation.

In addition, the DOC representative stated the agency has been actively pursuing savings strategies in-house since 2005, when DOC reported a 26% decrease in pharmaceutical spending resulting from the consolidation of several institutional pharmaceutical purchasing requirements into 1 contract. The DOC representative reported the agency has additional savings strategies planned, which they anticipate will add to the savings reported in 2005.

**IT HARDWARE**

**Addressable Spend** – The Fourth Amendment includes addressable spend of \$6,497,798 for the IT Hardware sourcing category. A.T. Kearney reported addressable spend of \$519,264 in the sourcing category close-out report, which is \$5,978,534 less than the amount included in the Fourth Amendment. The decrease resulted from the use of different baselines. The Fourth Amendment was based on total network hardware expenditures recorded in the State’s accounting system for the 4 participating agencies while addressable spend in the sourcing category close-out report was limited to servers and printers and was based on a combination of historical costs for printers and a calculation of costs for servers using Western States Contracting Alliance (WSCA) contract pricing multiplied by forecasted quantities for the 4 participating agencies. (WSCA is a multi-state purchasing consortium.) We do not agree with the methodology used to calculate the addressable spend attributable to servers. In addition, we did not receive sufficient supporting documentation for the addressable spend attributable to printers. Therefore, we have validated addressable spend of \$0.

The IT Hardware sourcing category includes 2 components: servers and printers. A.T. Kearney used different methodologies to calculate the addressable spend for each component. The following paragraphs summarize the calculations performed.

**Servers** – A.T. Kearney reported addressable spend for servers of \$429,053. We were unable to validate the amount reported.

To calculate addressable spend for servers, A.T. Kearney requested state agencies submit their minimum server system requirements and the quantity of servers planned for purchase over the next 12 months. After the requested information was submitted, the state agencies collectively revised and consolidated requirements in order to establish a list of product specifications applicable to all state agencies. As a result, 7 server categories are included in the calculation of addressable spend. **Table 15** summarizes the calculated addressable spend applicable to servers for the 4 participating agencies.

**Table 15**

<b>Description</b>	<b>Base Unit WSCA Price</b>	<b>Options WSCA Price</b>	<b>Total Price</b>	<b>Quantity</b>	<b>Calculated Addressable Spend</b>
Entry level server	\$ 3,247	2,257	5,504	3	\$ 16,512
Mid range 1 server	4,497	2,671	7,168	29	207,872
Mid range 2 server	4,536	3,031	7,567	1	7,567
High end server	8,428	10,175	18,603	-	-
Blade 1 server	3,351	1,999	5,350	10	53,500
Blade 2 server	7,542	-	7,542	3	22,626
Blade 3 server	3,713	3,848	7,561	16	120,976
<b>Total</b>				<b>62</b>	<b>\$ 429,053</b>

Addressable spend was calculated based on the responses to the Request for Quotation (RFQ) issued by DAS. The current WSCA contract costs included in the proposal received from Hewlett Packard (HP) became the basis for the calculations performed by A.T. Kearney. As stated previously, baseline quantities for each server category were based on the state agencies’ forecasted quantities. A.T. Kearney calculated addressable spend by multiplying the forecasted quantities provided for each server type by the sum of the HP WSCA price for a representative server model plus options.

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**Table 16** illustrates A.T. Kearney’s calculation of addressable spend using entry level servers as an example. The 4 participating agencies forecasted a need of 3 entry level servers over the next 12 months. A.T. Kearney assumed the baseline price of those models plus options was the current HP WSCA price.

**Table 16**

<b>Description</b>	<b>Quantity</b>	<b>Base Unit HP WSCA Price</b>	<b>Options HP WSCA Price</b>	<b>Total HP WSCA Price</b>	<b>Amount</b>
Entry level server	3	\$ 3,247	2,257	5,504	16,512

The use of forecasted quantities is not consistent with the “Savings Calculation” definition included in **Appendix A**. Therefore, we were unable to validate reported addressable spend for servers.

In addition, the use of HP’s current WSCA contract price for a representative model as the baseline price is not consistent with the “Savings Calculation” definition included in **Appendix A**. A.T. Kearney did not use actual state sales data to calculate baseline spend. Rather, A.T. Kearney assumed the HP WSCA prices multiplied by the forecasted quantities was representative of baseline spend. Prior to the Initiative, there were multiple WSCA contracts with several vendors offering various models and options for each server category. Therefore, there is no assurance this assumption is accurate without reviewing actual sales data.

Printers – A.T. Kearney reported addressable spend for printers of \$90,211. We were unable to validate the amount reported.

A.T. Kearney calculated addressable spend by printer type for participating agencies using summarized fiscal year 2006 historical spend. **Table 17** summarizes the reported addressable spend and quantities for the 4 participating agencies.

**Table 17**

<b>Description</b>	<b>Quantity</b>	<b>Amount</b>
B&W desktop printer	24	\$ 4,694
B&W workgroup printer	31	23,400
B&W high volume printer	33	46,140
Color desktop printer	30	5,714
Color workgroup printer	5	10,263
Total	123	\$ 90,211

We did not receive sufficient supporting documentation for the summarized spreadsheets A.T. Kearney used to calculate addressable spend for printers. Therefore, we were unable to validate reported addressable spend for printers.

As stated previously, A.T. Kearney’s calculation of addressable spend for servers was not consistent with the “Savings Calculation” definition included in **Appendix A**. In addition, we did not receive sufficient supporting documentation for the addressable spend attributable to printers. Therefore, we were unable to validate reported addressable spend for the IT Hardware sourcing category.

**Targeted Savings** – A.T. Kearney’s savings strategy was to standardize specifications and consolidate volumes to 1 vendor contract. DAS evaluated responses from 5 vendors under the RFQ for the provision of servers and printers. After reviewing the RFQ responses, DAS entered into a contract with HP.

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**Table 18** compares the targeted savings included in the Fourth Amendment, the calculated targeted savings using the validated addressable spend and targeted savings percentage of 8% included in the Fourth Amendment and the validated actual savings for the IT Hardware sourcing category. For comparative purposes, the **Table** also includes the actual savings reported by A.T. Kearney in the IT Hardware close-out report. As illustrated by the **Table**, we were unable to validate actual savings. Therefore, targeted savings and calculated targeted savings were not met.

**Table 18**

Description	Per Fourth Amendment		Actual Savings	Validated Actual Savings
	Targeted Savings	Calculated Targeted Savings	Reported in Close-Out Report	
Savings amount	\$ 519,824	**	134,159	-

\*\* - Addressable spend was not validated; therefore, we are unable to determine calculated targeted savings.

The actual savings of \$134,159 reported by A.T. Kearney was comprised of 2 components: \$97,001 attributable to servers and \$37,158 attributable to printers. A.T. Kearney used different methodologies to calculate actual savings for each component. The following paragraphs summarize the calculations performed.

Servers – The actual savings of \$97,001 attributable to servers was calculated by subtracting new contract unit costs from representative unit costs for each server category and multiplying the difference by forecasted quantities. However, as previously stated, the use of forecasted quantities and representative unit costs to calculate baseline spend are not consistent with the “Savings Calculation” definition included in **Appendix A**. Therefore, we were unable to validate the actual savings reported for servers.

Printers – The actual savings of \$37,158 attributable to printers was calculated by subtracting the newly negotiated costs from the average historical costs by printer type and multiplying the difference by the historical quantities shown in **Table 17**. However, we did not receive sufficient supporting documentation for A.T. Kearney’s calculation of actual savings. Therefore, we were unable to validate the actual savings reported for printers.

As stated previously, A.T. Kearney’s calculation of actual savings for servers was not consistent with the “Savings Calculation” definition included in **Appendix A**. In addition, sufficient supporting documentation was not provided for the actual savings attributable to printers. Therefore, we were unable to validate reported actual savings for the IT Hardware sourcing category.

**PERSONAL COMPUTERS (PCs)**

Addressable Spend – The Fourth Amendment includes addressable spend of \$233,257 for the PCs sourcing category. A.T. Kearney reported addressable spend of \$926,000 in the sourcing category close-out report, which is \$692,743 more than the amount included in the Fourth Amendment. The increase resulted from the use of different baselines. The Fourth Amendment was based on expenditures recorded in the State’s accounting system for 3 of the participating agencies (IVH, DAS and DOC) while addressable spend in the sourcing category close-out report was based on a combination of historical costs for monitors and a calculation of costs for desktops/laptops using WSCA contract pricing multiplied by historical quantities for all 4 participating agencies. We have validated \$208,004 of the addressable spend reported. Because A.T. Kearney did not use actual historical contract rates or costs in its calculation of addressable spend for desktops/laptops, we were unable to validate the \$631,096 of addressable spend attributable to desktops/laptops. In addition, we adjusted the addressable spend attributable to monitors by \$86,900 to exclude DOT purchases made under a separate contract.

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The PCs sourcing category includes 2 components: desktops/laptops and monitors. A.T. Kearney used different methodologies to calculate the addressable spend for each component. The following paragraphs summarize the calculations performed.

Desktops/Laptops – A.T. Kearney reported addressable spend for desktops/laptops of \$631,096. We were unable to validate the amount reported.

To calculate addressable spend for desktops/laptops, A.T. Kearney performed the following:

- (1) Reviewed the State’s sales data from each vendor for fiscal year 2006 and categorized desktop/laptop purchases into 4 product categories: high-end desktops, basic desktops, 14” laptops and 15” laptops. For desktops, A.T. Kearney used the specifications from the RFQ to categorize each state purchase as either high-end or basic. For laptops, A.T. Kearney identified the total number of laptops purchased and assumed 80% of the purchases were 15” laptops and 20% were 14” laptops. After categorizing all state sales, A.T. Kearney summarized the volume of sales by vendor and product category.
- (2) Reviewed RFQ submissions from each of the 4 vendors who responded to the solicitation (HP, Dell, Gateway and Lenovo). Each vendor’s response included the current WSCA contract price for a representative model, a model selected by the vendor which met the minimum specification requirements for each product category. A.T. Kearney used the representative model price from the vendor RFQs as the current contract price per product category for each vendor.
- (3) For each product category, A.T. Kearney multiplied the representative model price by the historical quantity for each vendor to determine total baseline spend by vendor by product category.

**Table 19** summarizes A.T. Kearney’s calculation of addressable spend using Dell basic desktops as an example. In the RFQ, Dell reported its representative basic desktop model under the WSCA contract was the Optiplex 745 at a price of \$1,203. After analysis of Dell sales data, A.T. Kearney determined state customers purchased 19 Dell basic desktops.

<b>Description</b>	<b>Vendor</b>	<b>Model</b>	<b>Price</b>	<b>Quantity</b>	<b>Calculated Addressable Spend</b>
Basic Desktop	Dell	Optiplex 745	\$ 1,203	19	\$ 22,857

HP represents the majority of sales to the 4 participating agencies. However, we do not agree with the use of WSCA contract rates as baseline contract rates to calculate the addressable spend attributable to HP. Historical actual prices paid for HP desktops/laptops were not based on the WSCA contract. Rather, HP and DAS had a Bid Deal contract in which HP offered deeper discounts on specific models. DAS and DOT representatives stated the sourcing category team for PCs instructed A.T. Kearney not to use WSCA contract rates to compute baseline spend. Because the WSCA contract rates were not the actual historical prices paid, we were unable to validate reported addressable spend for desktops/laptops.

In addition, the representative models the other vendors reported may or may not have been representative of state purchases and costs incurred. Product variations and model differences could significantly impact the reliability of calculations using such assumptions. We determined product features and specifications could also have a significant impact on actual costs. The product categories were broad and included significant variations.

There were several other areas of concern which also precluded validation of addressable spend.

- A.T. Kearney estimated 80% of laptop purchases were 15” laptops and 20% were 14” laptops. This estimate was supported by e-mail correspondence between A.T. Kearney and DAS. A.T. Kearney requested a DAS representative confirm “the team mentioned that 80% of future laptop sales would be for 15” machines and 20% would be 14” machines.” The

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representative’s response was, “That is what I heard, yes.” This support is not sufficient and represents use of forecasted quantities, which is not consistent with the “Savings Calculation” definition included in **Appendix A**.

- During our review, we identified a product offered under the new HP contract which did not meet the minimum specifications of the contract. DAS officials stated they had not specifically approved the model. However, HP provided DAS information explaining the model had product features which made it comparable to the products meeting specifications. Despite this explanation, it does not appear DAS has adequate controls to ensure products HP lists as Iowa standard products meet the minimum specifications included in the contract. We requested explanation from DAS regarding HP listing a below-specifications model as an Iowa standard model. DAS responded the model was allowed on the website for the benefit of political subdivisions and educational institutions which reference Iowa’s standard listing and currently purchase the model. However, there are no controls in place to ensure State agencies purchase the models which have been mandated instead of the models offered for the benefit of other entities.
- Product category prices and models changed from the date of contract award to the date of our review. In the close-out report, A.T. Kearney reported costs for 14” and 15” laptops under the new contract were \$900 and \$800, respectively. At the time of our review, 14” and 15” laptops on the HP website for Iowa state agencies were \$788 and \$750, respectively. DAS stated the prior models were replaced by new models and were approved by the State. Due to multiple price fluctuations and model changes during the review period, use of 1 model at a specific price multiplied by historical quantities to determine addressable spend for each product category would not be accurate.

We held meetings with DAS regarding these issues and stated we would need actual historical cost averages from the State for fiscal year 2006 purchases, exclusive of upgrades not included in the new contract rates, in order to determine addressable spend for desktops and laptops. However, collecting and analyzing actual sales data would be cost and time intensive. Therefore, DAS did not pursue additional data analysis.

Monitors – A.T. Kearney reported addressable spend for monitors of \$294,904. We validated addressable spend of \$208,004. The difference is a result of an \$86,900 adjustment for DOT purchases made under a separate contract.

A.T. Kearney calculated addressable spend by vendor and monitor type using fiscal year 2006 historical spend and quantities. **Table 20** summarizes reported addressable spend and quantities for the 4 participating agencies, less the DOT purchases made under a separate contract.

**Table 20**

Description*	Quantity	Amount
HP 15” flat monitor	61	\$ 11,590
HP 17” flat monitor	206	50,803
HP 19” flat monitor	337	123,827
HP 20” flat monitor	28	16,920
HP 23” flat monitor	6	4,864
Total	638	\$ 208,004

\* - HP was the only vendor who supplied monitors to the 4 participating agencies during the period under review (after the adjustment for DOT).

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**Table 21** summarizes the calculation of validated addressable spend for the PCs sourcing category.

<b>Description</b>	<b>Amount</b>
Addressable spend per the close-out report	\$ 926,000
Less:	
Addressable spend reported for desktops/laptops	(631,096)
Adjustment for DOT monitor purchases	(86,900)
Validated addressable spend	<u>\$ 208,004</u>

**Targeted Savings** – A.T. Kearney’s savings strategy was to standardize specifications and consolidate volumes to 1 vendor contract. DAS evaluated responses from 4 vendors under the RFQ for the provision of personal computers. After reviewing the RFQ responses, DAS entered into a contract with HP.

**Table 22** compares the targeted savings included in the Fourth Amendment, the calculated targeted savings using the validated addressable spend and targeted savings percentage of 4% included in the Fourth Amendment and the validated actual savings for the PCs sourcing category. For comparative purposes, the **Table** also includes the actual savings reported by A.T. Kearney in the PCs close-out report. As illustrated by the **Table**, we validated actual savings of \$50,028. Therefore, validated actual savings exceeded targeted savings and calculated targeted savings in accordance with the Fourth Amendment.

<b>Description</b>	<b>Per Fourth Amendment</b>		<b>Actual Savings</b>	<b>Validated</b>
	<b>Targeted Savings</b>	<b>Calculated Targeted Savings</b>	<b>Reported in Close-Out Report</b>	<b>Actual Savings</b>
Savings amount	\$ 9,330	8,320	319,388	50,028

The actual savings of \$319,388 reported by A.T. Kearney was comprised of 2 components: \$200,346 attributable to desktops/laptops and \$119,042 attributable to monitors. A.T. Kearney used different methodologies to calculate actual savings for each component. The following paragraphs summarize the calculations performed.

**Desktops/Laptops** – The actual savings of \$200,346 attributable to desktops/laptops was calculated by subtracting new contract unit costs from representative unit costs for each product category and multiplying the difference by historical quantities. However, as previously stated, the representative unit costs used in this calculation were based on WSCA contract rates and WSCA was not the current contract for desktops/laptops at the time of the Initiative. Therefore, we were unable to validate the actual savings reported for desktops/laptops.

**Monitors** – The actual savings of \$119,042 attributable to monitors was calculated by subtracting the newly negotiated costs from the average historical costs by monitor type and multiplying the difference by the historical quantities shown in **Table 20**. However, we do not agree with this methodology. New contract models were continually introduced throughout the period of review and significant price differences between models and market fluctuations were identified. Therefore, we calculated actual savings by comparing the average historical discounts from HP list prices to the average discounts from HP list prices negotiated under the new contract and multiplying the difference by fiscal year 2006 spend for each monitor type.

For example, the average discount state customers received in fiscal year 2006 for 20” flat monitors was 11.75% and the newly negotiated contract rates were discounted 23.8%. The new contract resulted in 12.05% in savings (23.8% - 11.75%). The 4 participating agencies spent

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\$16,920 on 20" flat monitors in fiscal year 2006; therefore, actual savings for 20" flat monitors was calculated at \$2,039 (12.05% x \$16,920). As a result of this analysis, we validated actual savings of \$50,028 for monitors.

**Table 23** summarizes the calculation of validated actual savings for the PCs sourcing category.

<b>Description</b>	<b>Amount</b>
Actual savings per the close-out report	\$ 319,388
Less:	
Actual savings reported for desktops/laptops	(200,346)
Adjustment for change in methodology	(69,014)
Validated actual savings	<u>\$ 50,028</u>

Realized savings may vary significantly from the amount presented in **Table 23** depending on the monitor needs of each participating agency and whether the agencies use the newly negotiated contract. Although DAS mandated state agency use of the contract, DOT, 1 of the 4 participating agencies, is exempt from the mandate. Therefore, if DOT elected to purchase monitors from a vendor other than HP or through use of another contract, it would impact the realized savings.

**SMALL PACKAGE EXPRESS DELIVERY**

**Addressable Spend** – The Fourth Amendment includes addressable spend of \$367,263 for the Small Package Express Delivery sourcing category. This amount is based on all 4 agencies participating in Wave 2 of the Initiative. A.T. Kearney reported addressable spend of \$491,145 in the sourcing category close-out report, which is \$123,882 more than the amount included in the Fourth Amendment. The increase resulted from the use of different time periods and the use of projected volumes from vendor reports versus use of the State’s accounting system. We have validated \$480,604 of the addressable spend reported. We determined the source data for addressable spend included 13 months of sales data for one vendor. The \$10,541 adjustment to validated addressable spend results from limiting total sales for that vendor to 12 months.

Addressable spend includes identifiable sales for United Parcel Service (UPS) and Federal Express (FedEx). The addressable spend was supported by spend reports from these 2 vendors detailing the State’s usage by shipping zone and weight and vendor costs by cost category. UPS projected sales were determined by multiplying UPS’ reported average weekly sales by 52 weeks. FedEx’s sales were based on actual sales for March 2006 through March 2007. Additional spend not included consisted of an immaterial amount of UPS spend without sufficient detail for analysis and spend with SpeeDee and DHL. A.T. Kearney excluded SpeeDee and DHL from addressable spend due to minimal sales volume and lack of services to multiple state agencies. In addition, while A.T. Kearney indicated improved user education would likely reduce spend volumes to these vendors, they did not include them in addressable spend and actual savings calculations in an effort to maintain a conservative estimate of actual savings.

**Table 24** summarizes the components of validated addressable spend for the Small Package Express Delivery sourcing category. For UPS, addressable spend consists of base rates, fuel surcharges and delivery area surcharges and, for FedEx, addressable spend equals the net of base rates, surcharges, duties, fees and discounts.

<b>Description</b>	<b>Amount</b>
UPS	\$ 354,414
FedEx	126,190
Total	<u>\$ 480,604</u>

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**Targeted Savings** – DAS elected to pursue redirection of certain FedEx services to UPS Ground services. The specific FedEx services recommended for redirection included ground deliveries, 2-day deliveries, 3-day deliveries, residential delivery and standard overnight delivery.

Although total addressable spend for the Small Package Express Delivery sourcing category is \$480,604, as shown in **Table 24**, the actual savings reported by A.T. Kearney in the sourcing category close-out report is based only on the \$126,190 portion of addressable spend attributable to FedEx services. Because the savings calculation is limited to specific FedEx services identified by A.T. Kearney, the actual savings is applied only to the addressable spend associated with FedEx.

**Table 25** compares the targeted savings included in the Fourth Amendment, the calculated targeted savings using the validated addressable spend and targeted savings percentage of 15% included in the Fourth Amendment and the validated actual savings for the Small Package Express Delivery sourcing category. For comparative purposes, the **Table** also includes the actual savings reported by A.T. Kearney in the Small Package Express Delivery close-out report. As illustrated by the **Table**, we validated actual savings of \$297. Therefore, targeted savings and calculated targeted savings were not met.

**Table 25**

Description	Per Fourth Amendment		Actual Savings Reported in Close-Out Report	Validated Actual Savings
	Targeted Savings	Calculated Targeted Savings		
Savings amount	\$ 55,090	72,091	6,757	297

The validated actual savings of \$297 for the participating agencies was calculated by comparing total UPS charges to total FedEx charges and multiplying the difference by the quantities provided by FedEx. However, realized savings will vary depending on the actual volume of FedEx services shifted to UPS. **Table 26** summarizes the validated actual savings for the participating agencies.

**Table 26**

Agency	Amount
DOT	\$ 168
DOC	119
IVH	6
DAS	4
Total	\$ 297

The actual savings of \$6,757 reported by A.T. Kearney was calculated by comparing UPS base rates to FedEx base rates and multiplying the difference by the quantities provided by FedEx. This resulted in actual savings of \$12,840. In addition, A.T. Kearney calculated fuel surcharge savings of \$1,889 by multiplying the calculated base rate savings by the difference between UPS and FedEx fuel surcharge rates for total actual savings of \$14,729. Of that amount, \$6,757 is applicable to the 4 agencies participating in Wave 2. However, A.T. Kearney’s actual savings calculation did not include all price factors. As previously stated, UPS charges base rates, fuel surcharges and delivery area surcharges and FedEx charges base rates and surcharges, with adjustments for duties, fees and discounts. A.T. Kearney included only base rates and fuel surcharges in their calculation of actual savings.

A.T. Kearney presented 3 options to DAS representatives in the Small Package Express Delivery close-out report in April 2007, as follows:

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- (1) To utilize the current contracts of other states in an effort to achieve better results due to increased leverage.
- (2) To implement a demand management program seeking to move appropriate volumes of spend from air to ground services.
- (3) To pursue a consortium contract for the National Association of State Procurement Officials (NASPO) for midwest and northeastern states.

DAS chose to pursue the consortium contract with other states in an effort to leverage buying power and reduce small package express delivery expenses for the state. DAS' goal for contract issuance was July 2007. However, A.T. Kearney advised the contract efforts would more than likely not be completed by July. Because savings under the NASPO contract would not occur as a direct result of the Strategic Sourcing Initiative, A.T. Kearney recommended alternate savings opportunities for the interim period and did not claim savings for the NASPO contract. A.T. Kearney recommended utilizing the current contracts of other states until the consortium contract could be finalized. DAS declined this recommendation in order to focus on the consortium contract.

A.T. Kearney then recommended the state implement a demand management program both as a good business practice and as a framework for achieving the best results with the consortium contract. DAS agreed with this recommendation; therefore, the redirection of certain FedEx services to UPS was implemented under the Strategic Sourcing Initiative. Subsequent to the completion of the Initiative, DAS signed a NASPO contract for small package express delivery with DHL effective January 18, 2008. As a result, actual savings estimates under the demand management program should be limited to 9 months rather than the 12 months validated. However, the resulting adjustment would be immaterial. Therefore, we validated actual savings based on the 12-month period reported.

### **SALT**

**Addressable Spend** – The Fourth Amendment includes addressable spend of \$10,514,768 for the Salt sourcing category. This amount is based solely on DOT, which is the agency responsible for the purchase of road salt for the State. A.T. Kearney reported addressable spend of \$8,870,325 for DOT and \$3,435,349 for political subdivisions for a total of \$12,305,674 in the sourcing category close-out report. The \$3,435,349 attributable to political subdivisions is not consistent with the “Addressable Spend” definition included in **Appendix A**. Therefore, we did not validate that portion of reported addressable spend. The DOT addressable spend of \$8,870,325 is \$1,644,443 less than the amount included in the Fourth Amendment. The decrease resulted from the use of different time periods. The Fourth Amendment was based on fiscal year 2005 object codes while the sourcing category close-out report was based on fiscal year 2007 awarded business. We have validated the addressable spend of \$8,870,325 reported for DOT.

Addressable spend for DOT was calculated based on tonnage requirements listed in DOT's fiscal year 2007 Request for Proposal (RFP) and average vendor contract rates for fiscal year 2007. For example, DOT's fiscal year 2007 RFP required 2,130 tons of road salt for the Williams location and the average fiscal year 2007 cost per ton for that location was \$45.35. Therefore, addressable spend for the Williams location was \$96,595.50 (2,130 X \$45.35).

**Targeted Savings** – DOT evaluated responses from 7 vendors under the RFP for the provision of road salt. After reviewing the RFP responses, DOT entered into contracts with all 7 vendors. The 1-year contracts were effective July 1, 2007.

**Table 27** compares the targeted savings included in the Fourth Amendment, the calculated targeted savings using the validated addressable spend and targeted savings percentage of 3% included in the Fourth Amendment and the validated actual savings for the Salt sourcing category. For comparative purposes, the **Table** also includes the actual savings reported by A.T. Kearney in the Salt close-out report. As illustrated by the **Table**, we were unable to validate actual savings. Therefore, targeted savings and calculated targeted savings were not met.

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**Table 27**

Description	Per Fourth Amendment		Actual Savings Reported in Close-Out Report	Validated Actual Savings
	Targeted Savings	Calculated Targeted Savings		
Savings amount	\$ 315,443	266,110	**	-

\*\* - A.T. Kearney reported price increases; therefore, actual savings was not included in the close-out report.

A.T. Kearney reported price increases of \$690,000 for the Salt sourcing category. The price increases were calculated by applying the average price increase per ton from fiscal year 2007 to fiscal year 2008 to the estimated 2008 tonnage requirement for the State. Because the newly negotiated contracts resulted in price increases, A.T. Kearney did not report actual savings in the sourcing category close-out report. We confirmed prices increased by selecting a sample of vendor rates by location and comparing the fiscal year 2007 rates to the fiscal year 2008 rates. Therefore, we have validated actual savings of \$0.

A.T. Kearney presented 4 sourcing strategies to DOT representatives in the Salt close-out report with an estimated actual savings of \$480,000. After consideration of the sourcing strategies presented, DOT agreed to implement the fuel surcharges strategy through modification of the RFP. **Table 28** summarizes each sourcing strategy and the corresponding potential savings calculated by A.T. Kearney.

**Table 28**

Description	Amount
Fuel Adjustments – Include language in the RFP to allow DOT to take advantage of market fuel price decreases.	\$ 100,000
Liquidated Damages – Ensure suppliers have an incentive to maintain proper levels of service.	-
Competitive Sourcing – Issue an RFP to all qualified vendors, analyze the bid results and conduct negotiations.	300,000
Supplier Relationships – Discuss the strategic sourcing effort with current and new DOT suppliers.	80,000
<b>Total</b>	<b>\$ 480,000</b>

A.T. Kearney stated potential savings are estimates based on benchmarking, fuel cost data from the Department of Energy and experience. For fuel adjustments, we recalculated savings of \$82,550 using the methodology described by A.T. Kearney. The difference of \$17,450 is primarily due to our adjustment to tons shipped to be consistent with historical documentation. However, A.T. Kearney did not report the estimated potential savings associated with fuel adjustments since overall contract prices increased. Because DOT did not utilize the liquidated damages, competitive sourcing or supplier relationships strategies, we did not evaluate the methodology used to calculate the estimated potential savings.

In addition, A.T. Kearney identified several concerns regarding DOT’s procurement decisions in the Salt close-out report. DOT responded to these concerns in a letter to DAS dated September 27, 2007. The most significant concerns were as follows:

- (1) Overall Cost of Road Salt – A.T. Kearney reported DOT acknowledged it may be paying too much for road salt; however, it was willing to accept higher costs in order to ensure adequate supply. DOT does not concur with A.T. Kearney’s statement. DOT stated they informed A.T. Kearney price was not their only consideration as timely delivery at the best possible prices was their goal. DOT also stated, while A.T. Kearney’s low price strategy is admirable, low prices do not meet State needs if the road salt is not available when needed.

In addition, DOT evaluated the results of the fiscal year 2008 RFPs. Their evaluation indicated price increases were primarily due to the increased cost of production at the mines, barge rate increases and rail rate increases. DOT stated the terms and conditions of the contract appear to have had minimal impact on the pricing changes.

- (2) Fuel Price Adjustments – In the sourcing category close-out report, A.T. Kearney recommended DOT incorporate fuel price adjustments for price decreases into the contract to be consistent with the fuel surcharge increases currently included. As shown in **Table 28**, A.T. Kearney estimated savings of \$100,000 as a result of implementing this strategy. In addition, A.T. Kearney reported the 2008 contract included fuel surcharge increases triggered when market prices increased 20%, but fuel surcharge decreases were not triggered until market prices decreased 30%. A.T. Kearney stated this was a pricing advantage for vendors.

DOT stated they did incorporate A.T. Kearney’s recommendation for fuel price adjustments. They also indicated the 30% trigger for fuel surcharge decreases and the 20% trigger for fuel surcharge increases were recommended by A.T. Kearney during an April meeting based on Minnesota’s DOT contract. In addition, DOT stated, based on the \$2.77 per gallon price of diesel fuel at the time of contract letting, A.T. Kearney’s estimated savings of \$100,000 from fuel surcharge decreases would only become effective if diesel fuel prices dropped by \$0.83 per gallon. DOT agreed fuel prices tend to fluctuate, but it believes a fuel decrease to that degree is unlikely. Therefore, A.T. Kearney’s estimated savings of \$100,000 is also unlikely.

- (3) Competitive Sourcing and Supplier Relationships – A.T. Kearney reported DOT’s failure to challenge suppliers resulted in an overall road salt price increase of \$690,000 and unachieved estimated savings of \$480,000, which total an estimated \$1.2 million additional annual spend for road salt. A.T. Kearney purported Iowa could have negotiated a better outcome if they had more aggressively pursued savings by leveraging its large customer status and benchmarking against other states’ prices. DOT responded neither the sourcing category close-out report nor any other documentation support A.T. Kearney’s position.

DOT further explained it cannot risk damaging vendor relationships with the aggressive negotiation strategies recommended by A.T. Kearney. For example, DOT believes A.T. Kearney’s post-letting negotiation strategy could potentially yield short-term savings, but it believes that strategy may damage vendor relationships, which could result in higher costs and/or reduced delivery security. DOT emphasized the need to maintain positive working relationships with vendors in order to maintain delivery security, especially given the limited number of vendors available to provide road salt. DOT also stated benchmarking against other state contracts is already a part of the state’s bid evaluation process.

## **OFFICE FURNITURE**

**Addressable Spend** – The Fourth Amendment includes addressable spend of \$180,272 for the Office Furniture sourcing category. A.T. Kearney reported addressable spend of \$539,107 in the sourcing category close-out report, which is \$358,835 more than the amount included in the Fourth Amendment. The increase resulted from a change in the scope of the category. The Fourth Amendment was based on statewide spend recorded in the State’s accounting system. However, the sourcing category close-out report was based on a cost estimate specifically related to the furniture purchase DAS completed on behalf of the Department of Public Safety (DPS). We do not agree with the methodology used to arrive at addressable spend. Therefore, we have validated addressable spend of \$0.

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Addressable spend only includes the modular office furniture DAS purchased on behalf of DPS for furnishing the new DPS building, excluding installation costs. This was a one-time purchase, and no other office furniture expenditures incurred by the State were included. Addressable spend was calculated based on the responses to the Request for Bid (RFB) issued by DAS. The proposal received from Pigott, Inc. (Pigott), the highest of the 3 proposals received, became the basis for the calculations performed by A.T. Kearney, as follows:

- (1) To calculate Pigott’s baseline cost of \$644,864.83, A.T. Kearney determined the extended list prices of the new Herman Miller products proposed by Pigott and adjusted those list prices based on average Herman Miller product discounts provided to other states. The adjusted prices became the baseline prices used by A.T. Kearney for new Herman Miller products. **Table 29** illustrates the calculation performed.

**Table 29**

Description	Amount
Pigott Extended List Prices	\$ 1,826,812.55
Multiplied by:	
Average Herman Miller Discount for Other States	64.7%
Calculated Pigott Baseline Cost	\$ 644,864.83

- (2) A.T. Kearney then determined the difference between the proposals received from Pigott and Office Systems Exchange (OSE), the vendor awarded the contract. They developed a calculation to compare the costs of the new Herman Miller products offered by Pigott to the Herman Miller compatible products offered by OSE. A.T. Kearney then used this comparison to determine the discount attributable to product differences. **Table 30** illustrates the comparison performed. The discount percentages used were identified by A.T. Kearney during review of the vendor proposals. The example in the **Table** is calculated assuming a new Herman Miller product cost of \$100.

**Table 30**

Description	Pigott	OSE	Remarks
List Price	\$100.00	59.00	A.T. Kearney determined OSE’s list prices averaged 59% of Pigott’s list prices (\$100 x 59% = \$59).
Proposed Discount	75.29%	65.00%	Discount percentages were included in the responses to the RFB.
Proposed Discount Price	\$24.71	20.65	Proposed discount price is calculated by multiplying the list price by the proposed discount and subtracting the result from the list price (i.e., [\$24.71 = (\$100 x (1-.7529))]).
Average Discount of Compatible Herman Miller Off New Herman Miller		16.4%	The OSE price divided by the Pigott price equals the average discount (100% - (\$20.65/\$24.71) = 16.4%).

- (3) A.T. Kearney then calculated OSE baseline costs of \$539,107 based on the calculated Pigott baseline costs and the average discount calculated in step 2. A.T. Kearney applied the 16.4% discount to Pigott’s baseline costs of \$644,864.83, calculated in step 1, to determine OSE’s baseline cost, which became the addressable spend for the Office Furniture sourcing category. **Table 31** illustrates the calculation of OSE baseline costs.

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**Table 31**

Description	Amount
Calculated Pigott Baseline Costs	\$ 644,864.83
Multiplied by:	
Pigott price less average OSE discount (i.e., 100% - 16.4%)	83.6%
Calculated OSE Baseline Costs	\$ 539,107.00

Using another bidder’s pricing to calculate addressable spend is not consistent with the “Addressable Spend” definition included in **Appendix A**. Therefore, we validated addressable spend of \$0.

**Targeted Savings** – DAS evaluated responses from 3 vendors under the RFB for the provision of office furniture for DPS. After reviewing the RFB responses, DAS awarded the contract to OSE. As stated previously, the contract was awarded for the provision of modular office furniture for the new building being furnished by DPS. Prices awarded under the contract did not extend to any other office furniture purchases made by the State.

**Table 32** compares the targeted savings included in the Fourth Amendment, the calculated targeted savings using the validated addressable spend and targeted savings percentage of 10% included in the Fourth Amendment and the validated actual savings for the Office Furniture sourcing category. For comparative purposes, the **Table** also includes the actual savings reported by A.T. Kearney in the Office Furniture close-out report. As illustrated by the **Table**, we were unable to validate actual savings. Therefore, targeted savings and calculated targeted savings were not met.

**Table 32**

Description	Per Fourth Amendment		Actual Savings Reported in Close-Out Report	Validated Actual Savings
	Targeted Savings	Calculated Targeted Savings		
Savings amount	\$ 18,027	**	140,688	-

\*\* - Addressable spend was not validated; therefore, we are unable to determine calculated targeted savings.

The actual savings of \$140,688 reported by A.T. Kearney was calculated by comparing the reported addressable spend of \$539,107 to OSE’s proposal of \$398,419. While this comparison demonstrates how competitive bidding helps achieve lower prices, it does not represent a savings calculation consistent with the definition included in **Appendix A**. Therefore, we were unable to validate the actual savings reported.

We identified several other issues related to the savings calculation methodology for the Office Furniture sourcing category which also preclude validation of actual savings, as follows:

- The methodology for the Office Furniture sourcing category is not consistent with the other sourcing categories, which are for the provision of a type of commodity or service and not a specific project. The Office Furniture sourcing category actual savings are based on a one-time modular furniture procurement and prices awarded do not carry forward to future state furniture purchases. Therefore, future savings as a result of the Strategic Sourcing Initiative will not occur for this sourcing category.
- Iowa Prison Industries (IPI) objected to the OSE contract in accordance with Section 904.808 of the *Code of Iowa*, which states a product possessing the performance characteristics of a product listed in IPI’s price lists shall not be purchased by any department or agency of the state government from a source other than IPI, except in emergencies or upon application and approval of a waiver signed by IPI.

As a result of IPI's objection, DAS modified its procurement policies. DAS stated it previously operated under the assumption if IPI participated in the bidding process and was not the successful bidder, the purchasing agency could purchase from another vendor. However, DAS' policies now do not allow DAS to establish a contract or even conduct a bid if the item is on IPI's website.

- After awarding the contract to OSE, DPS made significant adjustments to the requirements under the contract. OSE's original proposal for modular furniture for the project was \$398,419, but the actual awarded amount is \$457,577, which is a price increase of \$59,158. Because addressable spend, actual savings and the other vendors' proposals are all based on the original modular furniture requirement, the actual savings calculated became invalid.

**MAINTENANCE SERVICES**

**Addressable Spend** – The Fourth Amendment includes addressable spend of \$2,484,635 for the Maintenance Services sourcing category. A.T. Kearney reported addressable spend of \$48,336 in the sourcing category close-out report, which is \$2,436,299 less than the amount included in the Fourth Amendment. The decrease resulted from a change in the scope of the sourcing category. The maintenance services included in the sourcing category were reduced to only the waste management and recycling services for the Des Moines metropolitan area, and DAS was the only participating state agency. We have validated the \$48,336 addressable spend reported.

Addressable spend includes both waste management and recycling services. A.T. Kearney calculated the amount by multiplying the 2006/2007 contract rates of the 2 vendors to whom a contract was awarded, Weyerhaeuser Company and Artistic Waste Services, and the 2008 forecasted quantities for waste management and recycling services managed by DAS in the Des Moines metropolitan area. **Table 33** summarizes the addressable spend reported for the Maintenance Services sourcing category by vendor.

<b>Description</b>	<b>Amount</b>
Weyerhaeuser Company*	\$ (18,886)
Artistic Waste Services	67,222
Total	<u>\$ 48,336</u>

\* - The negative addressable spend results from netting the proceeds received by the State for recyclables against the contract costs.

**Targeted Savings** – DAS evaluated responses from 6 vendors under the RFB for the provision of waste management and recycling services for DAS. After reviewing the RFB responses, DAS entered into contracts with 2 vendors, Weyerhaeuser Company and Artistic Waste Services. The contracts were effective on September 27, 2007 and September 28, 2007, respectively. The 1-year contract with Weyerhaeuser Company allows for 2 additional 1-year renewal periods and the 2-year contract with Artistic Waste Services allows for 3 additional 1-year renewal periods.

**Table 34** compares the targeted savings included in the Fourth Amendment, the calculated targeted savings using the validated addressable spend and targeted savings percentage of 5% included in the Fourth Amendment and the validated actual savings for the Maintenance Services sourcing category. For comparative purposes, the **Table** also includes the actual savings reported by A.T. Kearney in the Maintenance Services close-out report. As illustrated by the **Table**, we were unable to validate actual savings. Therefore, targeted savings and calculated targeted savings were not met.

**A Review of the Strategic Sourcing Initiative**

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**Table 34**

<b>Description</b>	<b>Per Fourth Amendment</b>		<b>Actual Savings Reported in Close-Out Report</b>	<b>Validated Actual Savings</b>
	<b>Targeted Savings</b>	<b>Calculated Targeted Savings</b>		
Savings amount	\$ 124,232	2,417	**	-

\*\* - A.T. Kearney reported price increases; therefore, actual savings was not included in the close-out report.

A.T. Kearney reported price increases of \$11,006 for the Maintenance Services sourcing category. The price increases were calculated by comparing the total spend increase (2006/2007 contract rates less 2008 contract rates multiplied by forecasted 2008 quantities) to the total proceeds for recyclables received by the State (2006/2007 contract proceed rates less 2008 contract proceed rates multiplied by forecasted 2008 quantities). We confirmed prices increased by verifying the unit price increases reported and recalculating estimated costs compared to historical costs. Therefore, we have validated actual savings of \$0.

## Calculated Savings

At DAS' request, we summarized the calculated savings which may result from Wave 2 of the Phase II Strategic Sourcing Initiative. Calculated savings is comprised of 2 components: first-year actual savings (first-year savings) for the non-participating state agencies and future savings extended for the duration of the newly awarded contracts implemented during the Initiative. The objective of our review was to validate actual savings for the 4 participating agencies. Therefore, we did not perform procedures to validate either actual savings attributable to the non-participating state agencies or future savings. Calculated savings reported in this section do not represent validated actual savings. They are estimates which could potentially be achieved if certain assumptions are met. However, there is no assurance the estimated amount will be realized.

To verify calculated savings, we performed the following:

- (1) Obtained the original contract terms, including available contract renewals, for the contracts DAS entered into as a result of Wave 2 of the Initiative.
- (2) Verified the mathematical accuracy of the calculation for first-year savings for non-participating state agencies using the limited information collected during review of each sourcing category.
- (3) Verified the mathematical accuracy of the calculation for statewide first-year actual savings (statewide savings).
- (4) Calculated future savings for each sourcing category which had validated actual savings using statewide savings and the contract terms provided by DAS.

**Table 35** summarizes the statewide savings A.T. Kearney reported in the sourcing category close-out reports for Wave 2. Statewide savings consists of 2 components: validated actual savings for the 4 participating state agencies and calculated first-year savings for the non-participating state agencies. A.T. Kearney reported actual savings for both the 4 participating state agencies and the non-participating state agencies in the sourcing category close-out reports. However, the purpose of our review was to validate actual savings for only the 4 participating state agencies. Therefore, we only verified the mathematical accuracy of the calculated first-year savings for the non-participating state agencies. The calculated first-year savings are estimated amounts which could potentially be achieved if certain assumptions are met. However, there is no assurance the estimated amounts will be realized.

**Table 35**

Sourcing Categories	Reported by A.T. Kearney			Verified by AOS**		
	Participating State Agencies	Non-Participating State Agencies	Total	Validated Actual Savings	Calculated First-Year Savings	Statewide Savings
Construction	\$ 653,432	-	653,432	-	-	-
Pharmaceuticals	298,000	-	298,000	-	-	-
IT Hardware	134,159	519,042	653,201	-	-	-
Personal Computers (PCs)	319,388	1,098,463	1,417,851	50,028	235,542	285,570
Small Package Express Delivery	6,757	7,972	14,729	297	349	646
Salt^	-	-	-	-	-	-
Office Furniture	140,688	-	140,688	-	-	-
Maintenance Services^	-	-	-	-	-	-
<b>Total</b>	<b>\$ 1,552,424</b>	<b>1,625,477</b>	<b>3,177,901</b>	<b>50,325</b>	<b>235,891</b>	<b>286,216</b>

^ - A.T. Kearney reported price increases for both the Salt and Maintenance Services sourcing categories; therefore, savings for both sourcing categories is \$0.

\*\* - AOS = Office of Auditor of State

As illustrated by the **Table**, for several sourcing categories, A.T. Kearney did not report first-year savings for state agencies other than the 4 participating state agencies. However, for the IT Hardware, PCs and Small Package Express Delivery sourcing categories, A.T. Kearney reported first-year savings for both participating and non-participating state agencies. We verified the mathematical accuracy of the calculation for the first-year savings reported for the non-participating state agencies in the PCs and Small Package Express Delivery sourcing categories. However, we did not evaluate the methodology used to develop the savings amounts. We were unable to validate first-year savings for the participating agencies in the IT Hardware sourcing category. Therefore, we did not verify the calculation of first-year savings reported for non-participating state agencies for that sourcing category.

Because we did not perform a comprehensive evaluation comparable to the validation process performed for the actual savings reported for the 4 participating state agencies, we have not validated the first-year savings reported for the non-participating state agencies. Based on the calculations provided, first-year savings for non-participating state agencies as a result of Wave 2 of the Initiative is \$235,891. This is an estimated amount which could potentially be achieved if certain assumptions are met. However, there is no assurance the estimated amounts will be realized.

**Table 36** summarizes the calculated future savings which may result from utilization of the contracts entered into as a result of Wave 2 of the Initiative. The future savings amounts were calculated by multiplying the statewide savings summarized in **Table 35** by the contract terms in years provided by DAS. **Table 36** only includes those sourcing categories for which there were validated actual savings for the 4 participating agencies.

**Table 36**

<b>Sourcing Categories</b>	<b>Statewide Savings</b>	<b>Contract Terms in Years</b>	<b>Calculated Future Savings</b>
Personal Computers (PCs)	\$ 285,570	2	\$ 571,140
Small Package Express Delivery	646	**	-
<b>Total</b>	<b>\$ 286,216</b>		<b>\$ 571,140</b>

\*\* - A new contract was not negotiated for the Small Package Express Delivery sourcing category. However, subsequent to the Initiative, DAS entered into a contract with DHL eliminating any future savings opportunities using A.T. Kearney's sourcing strategy.

**PERSONAL COMPUTERS (PCs)**

A.T. Kearney calculated statewide savings of \$1,417,851 for the PCs sourcing category. Of that amount, \$319,388 is attributable to the 4 participating state agencies, as described in the "Strategic Sourcing Categories" section of this report (page 25), and \$1,098,463 is attributable to the non-participating state agencies. However, the actual savings reported by A.T. Kearney included significant savings for desktops/laptops which were not calculated in accordance with the "Savings Calculation" definition included in **Appendix A**. We recalculated actual savings as part of our validation procedures. This recalculation resulted in adjusted statewide savings of \$285,570. Of that amount, \$50,028 is attributable to the 4 participating state agencies and \$235,542 is attributable to the non-participating state agencies.

According to a DAS representative, the HP contract has a 2-year term. Therefore, calculated future savings under the contract total \$571,140, as illustrated in **Table 36**. Because the

actual savings for desktops/laptops were not validated, the calculated future savings only apply to savings reported for monitors.

**SMALL PACKAGE EXPRESS DELIVERY**

As described in the “Strategic Sourcing Categories” section of this report (page 27), A.T. Kearney calculated statewide savings of \$14,729. Of that amount, \$6,757 is attributable to the 4 participating state agencies and \$7,972 is attributable to the non-participating state agencies. However, A.T. Kearney’s calculation of actual savings did not include all price factors. During the validation process, we recalculated actual savings. As a result of the recalculation, adjusted statewide savings is \$646. Of that amount, \$297 is attributable to the 4 participating state agencies and \$349 is attributable to the non-participating state agencies.

The demand management program A.T. Kearney recommended for the Small Package Express Delivery sourcing category was a temporary strategy to be used until DAS could complete a consortium contract with other states. On January 18, 2008, DAS signed a NASPO contract for small package express delivery with DHL. Effective that date, any future savings opportunities resulting from A.T. Kearney’s sourcing strategy were eliminated. Therefore, calculated future savings for the Small Package Express Delivery sourcing category are \$0.

## **ITEMS FOR FURTHER CONSIDERATION**

As a result of our review, we identified the following items for further consideration for DAS to evaluate the true savings of the Strategic Sourcing Initiative and more effectively manage potential future savings initiatives.

- As previously stated, actual savings identified as defined in the ATK Contract is an estimated savings amount and does not represent realized savings. Because the actual savings validated in this report is an estimated amount which could potentially be achieved if certain assumptions are met, consideration should be given to validation or review of the realized savings achieved by the end of fiscal year 2008 or 2009. The fiscal year to be reviewed would depend on the effective date of the contracts implemented for each sourcing category. This validation or review would use actual purchase information rather than projected information.
- It is not mandatory State agencies purchase from most of the contracts established as part of the Strategic Sourcing Initiative. The opportunity for “off contract” purchasing may reduce the actual savings realized. DAS should consider if changes should be made to purchasing requirements.
- Total payments to A.T. Kearney of \$882,260 for Phase II, Wave 2 exceed the validated actual first-year savings of \$50,325 by \$831,935. These payments represent A.T. Kearney’s fixed compensation for Wave 2 as outlined in the Fourth Amendment. DAS and the other participating agencies also incurred administrative costs and will incur audit costs related to the Initiative. In the future, DAS should consider all these cost factors when contracting with consulting firms and set net savings objectives and consulting firm fixed and variable compensation accordingly.
- The Fourth Amendment did not include consideration of pricing factors outside the control of the consulting firm. For example, the contract did not address natural market fluctuations which would significantly impact calculated savings. A.T. Kearney may have benefited from natural market price decreases in the PCs sourcing category but may have been negatively impacted by natural market price increases in the Salt sourcing category. DAS should consider evaluation of both current market pricing and historical state purchasing information when evaluating consulting firm effectiveness to protect both parties and to ensure savings achieved are the result of consulting firm efforts and not natural market changes.

## **Schedules**

**Schedule 1**

A Review of the Strategic Sourcing Initiative Administered  
by the Department of Administrative Services

State Agency Payments to DAS for the Strategic Sourcing Initiative by Fiscal Year  
For Fiscal Years 2005 through 2008

<b>Department/State Agency</b>	<b>Fiscal Year</b>				<b>Total**</b>
	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008*</b>	
Administrative Services	\$ 17,500.00	940,588.34	998,128.04	47,309.79	2,003,526.17
Board of Regents	-	37,455.78	-	256,787.00	294,242.78
Commerce	-	10,225.60	-	-	10,225.60
Corrections	17,500.00	166,692.57	50,173.14	-	234,365.71
Economic Development	17,500.00	26,415.05	10,636.85	-	54,551.90
Education	-	14,709.87	5,923.39	-	20,633.26
Governor and Management	-	950.00	382.54	-	1,332.54
Human Services	17,500.00	128,410.60	12,847.87	-	158,758.47
Iowa Communications Network	-	2,231.28	898.50	-	3,129.78
Judicial	-	264,893.18	-	-	264,893.18
Lottery	-	5,072.11	2,042.45	-	7,114.56
Natural Resources	17,500.00	62,581.01	25,200.21	-	105,281.22
Public Defense	-	8,258.04	3,325.36	-	11,583.40
Public Health	17,500.00	30,676.81	16,470.65	-	64,647.46
Public Safety	17,500.00	32,127.93	12,937.33	-	62,565.26
Revenue	17,500.00	24,295.56	9,783.37	-	51,578.93
Transportation	17,500.00	493,249.83	223,659.41	148,535.15	882,944.39
Veterans Affairs	17,500.00	24,409.62	13,579.30	5,000.00	60,488.92
Workforce Development	-	24,751.15	-	-	24,751.15
<b>Total</b>	<b>\$ 175,000.00</b>	<b>2,297,994.33</b>	<b>1,385,988.41</b>	<b>457,631.94</b>	<b>4,316,614.68</b>

\* - Fiscal year 2008 revenues are as of March 31, 2008. Additional revenues are anticipated by the end of the fiscal year.

\*\* - These amounts represent payments for all Phases and Waves of the Strategic Sourcing Initiative. In addition, DAS received an additional \$264,700.80 from state agencies through vehicle dispatch cash balance reductions in fiscal year 2006.

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A Review of the Strategic Sourcing Initiative Administered  
by the Department of Administrative Services

Staff

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**A Review of Wave 2 of the  
Strategic Sourcing Initiative  
Administered by the  
Department of Administrative Services**

## **Appendices**

A Review of the Strategic Sourcing Initiative Administered  
by the Department of Administrative Services

Definition of Terms

**Actual Contracted Annualized Savings (Actual Savings)** – Accumulation of dollars as determined through “Savings Calculations” defined below, for each sourcing category within the addressable spend. [Actual savings have not yet been realized, but are projected by the category sourcing team by applying the savings calculation to the addressable spend (or a portion of addressable spend) for a given sourcing category.]

**Addressable Spend** – The proportion of expenditures by the State in a given category that DAS, IPAs [defined below] and other Participating Departments or Agencies agree are considered viable for a strategic sourcing initiative. Addressable spend is a subset of the total sourceable spend for a given category. [Sourceable spend is the total amount spent by the State in a given category.]

**Audit or Independent Audit** – An audit performed by someone other than the Contractor or DAS, paid for and procured by DAS, conducted to verify and validate the Contractor’s identified Participating Departments’ cost savings (actual savings) achieved due to the purposes of this contract and efforts of the Contractor.

**Category Sourcing Team** – Combination of Contractor and Agency resources that will work jointly to source each category. Category teams include individuals identified by the Participating Departments who are knowledgeable in the areas of procurement and use of the specific goods and services being sourced.

**Independent Purchasing Authority (IPA)** – Those State of Iowa entities or agencies that under Iowa Code have separate and distinct purchasing ability, including the ability to contract autonomously.

**Savings Calculation** – The Calculated Savings Dollars achieved shall be determined by comparing the difference between the Strategic Sourcing initiative’s newly negotiated prices and the representative Total Baseline Spend made up of the State’s current prices, multiplied by the estimated volume for the identified baseline period (i.e. spend volume for FY2005, or the most recent historical procurement data where available, for each Participating Department and Independent Purchasing Authority for each Sourcing Category). Any additional value or savings, deemed to be material in nature, that is obtained by the State through improvements in the total cost of ownership components (e.g. payment terms, delivery, maintenance, service, warranty, credits, etc.) or cost reductions and cost avoidance (e.g. specification changes or substitutions that avoid costs or reduce proposed supplier cost increases) will also be considered as part of the Total Calculated Savings Dollars. The Total Calculated Savings Dollars would be divided by the Total Baseline Spend to determine a Calculated Savings Percentage. This Calculated Savings Percentage would be multiplied by the Total Category Addressable Spend, as defined as part of the category profile deliverable, in order to determine the Actual Contracted Annualized Savings amount.

Wherever possible, savings dollars should be calculated using all reasonably available pricing and spend information. When pricing information is not available, the prices spent on goods or services with the vendor with the highest annual expenditure shall be used to calculate savings dollars.

**Sourcing Categories** – Those goods and services which have been identified by the parties to comprise the Wave 2 category initiative. Changes to the identified categories will be jointly agreed upon in writing.

**Spend Volume** – Total volume of spend by each Agency for a given category. All spend is not considered addressable during a strategic sourcing initiative.

**Target(ed) Contracted Annualized Savings (Targeted Savings)** – The amount of savings projected by the Contractor as the amount which can be saved for Wave 2. [This was specified as \$1,576,685 in the Fourth Amendment; the Fourth Amendment includes a Table which specifies the targeted savings to be achieved for each sourcing category.]

**Wave or Strategic Sourcing Wave** – A combination of certain goods and services for focused efforts in sourcing to achieve savings to the State of Iowa when purchasing those goods and services.

**Work Streams** – Initiatives identified by DAS and the Contractor to be implemented to achieve savings on goods and services contracts.

**Validate** – To substantiate or verify the amount presented by the category sourcing team. Amounts were validated by assessing the methodology used in their calculation and reviewing the source data used to ensure it was accurate and complete. The amounts validated included addressable spend and savings calculations.