



February 2009  
PE 08-22-446

## House Concurrent Resolution Number 88 Study on Vendor Preferences

### AUDIT OVERVIEW

**The Legislative Auditor Found  
That the Number of State  
Contracts Awarded Through Vendor  
Preferences Is Relatively Small**



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## OBJECTIVE, SCOPE & METHODOLOGY

During the 2008 legislative session, the West Virginia Legislature passed House Concurrent Resolution Number 88 which requested that the Joint Committee on Government and Finance study the policies and procedures for awarding vendor preferences in state purchasing contracts, and determine whether the existing vendor preferences accomplish the goals of the Legislature in establishing vendor preferences.

### **Objective**

Pursuant to HCR 88, the Performance Evaluation and Research Division of the Legislative Auditor's Office conducted research to determine the frequency in which vendor preferences were requested in the competitive bid process, to calculate the percentage and dollar amounts of contracts awarded through preferences, and to evaluate the vendor preference procedures to determine if there are areas in need of improvements.

### **Scope**

The scope of this study consisted of a random sample of Request for Quotations and all Request for Proposals for contracts awarded in fiscal year 2008.

### **Methodology**

In order to gather information pertaining to the request of HCR 88, the Legislative Auditor reviewed the West Virginia Code and corresponding rules. The Legislative Auditor also communicated with the Purchasing Division regarding the application of vendor preferences. The Purchasing Division indicated that it did not keep track of which vendors apply for preferences or how often the application of vendor preference impacts which vendor is awarded state contract. Therefore, the Legislative Auditor sampled RFQs and reviewed all RFPs for FY 2008 from lists provided by the Purchasing Division. The total number of RFQs is 1,026 and the total number of RFPs is 13. The sample for

RFQs was randomly selected. In regards to the Reciprocal Vendor Preference, the Legislative Auditor surveyed Kentucky, Maryland, Ohio, Pennsylvania, and Virginia. In addition to this survey, the Legislative Auditor obtained additional information for all states regarding vendor preferences through internet research.

## ISSUE 1

### **The Legislative Auditor Found That the Number of State Contracts Awarded Through Vendor Preferences Is Relatively Small.**

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#### **Issue Summary**

In response to House Concurrent Resolution Number 88 (HCR 88), passed during the 2008 legislative session, the Legislative Auditor reviewed the State's vendor preferences in contracting for commodities and services to determine their effectiveness in accomplishing their goals. There are three vendor preferences that are designed to give West Virginia vendors who bid on a contract an award advantage over out-of-state vendors. The Legislative Auditor estimates that the Resident Vendor Preference was applied for in 25 percent of competitive bids during fiscal year 2008. However, in the large majority of these cases, the preference did not tip the scales in favor of in-state vendors who applied for the preference. Furthermore, in a few cases the Purchasing Division neglected to factor in the vendor preference for bidders who applied for it. The Reciprocal Vendor Preference has not been enforced by the Purchasing Division since its inception in 1990. Given that the Purchasing Division has not consistently applied the Resident Vendor Preference and it has not applied the Reciprocal Vendor Preference, it is possible that the goals of the Legislature in establishing vendor preferences are not presently being met. It may also be that the current vendor preference percentage limits are insufficient to have a significant impact on awarding contracts to in-state vendors.

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*The Legislative Auditor estimates that the Resident Vendor Preference was applied for in 25 percent of competitive bids during fiscal year 2008.*

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*Given that the Purchasing Division has not consistently applied the Resident Vendor Preference and it has not applied the Reciprocal Vendor Preference, it is possible that the goals of the Legislature in establishing vendor preferences are not presently being met.*

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#### **West Virginia House Concurrent Resolution Number 88**

During the 2008 legislative session, HCR 88 was passed requesting that the Joint Committee on Government and Finance study the policies and procedures for awarding vendor preferences in state purchasing contracts, and determine whether the existing vendor preferences accomplish the goals of the Legislature. The objective of this review is to:

1. determine the frequency in which vendor preferences are requested in the competitive bid process of state commodities and services,
2. calculate the percentage and dollar amounts of contracts awarded through preferences, and
3. evaluate the vendor preference policies and procedures to determine if there are areas in need of improvements.

## The State Has Three Vendor Preferences

There are three vendor preferences allowed by the State, all of which are designed to give preference to in-state residents in the competitive bid process. These preferences are:

- Resident Vendor Preference,
- Veteran Resident Vendor Preference, and the
- Reciprocal Vendor Preference.

During the 2008 legislative session, legislation was proposed that would have added the following vendor preferences:

- Small Business Vendor Preference,
- Minority Owned Business Vendor Preference, and
- West Virginia Manufactured Vendor Preference.

The legislation also proposed a 10 percent limit on the total preference granted to any vendor. Currently, the limit is five percent.

The Resident Vendor Preference gives preference to vendors who are located in West Virginia or who employ a certain number of West Virginia residents. The Resident Vendor Preference is applied to both in-state and out-of-state vendors who meet certain requirements. A West Virginia vendor may be eligible for two separate 2-1/2-percent Resident Vendor Preferences, combining for a total of five percent preference. The out-of-state bid is increased by five percent during the

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*The Resident Vendor Preference gives preference to vendors who are located in West Virginia or who employ a certain number of West Virginia residents.*

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evaluation process. Resident Vendor Preferences are not applied **among** West Virginia resident vendors; they are only applied when out-of-state vendors compete **against** West Virginia vendors.

For example, if a resident vendor, claiming the Resident Vendor Preference, bids \$25,000 and the out-of-state vendor bids \$24,500, then the out-of-state bid would be increased by five percent, which would increase the out-of-state bid to \$25,725, allowing the resident vendor to win the bid, with a lower amount.

In order to apply for the first 2-1/2-percent of the Resident Vendor Preference, vendors must certify that they meet one of the following requirements:

- The vendor has been an individual resident for four years.
- The vendor has been a partnership/corporation with either its headquarters, or a principal business office in the state for four years prior to certification.
- The vendor has at least 80 percent of the vendor's ownership held by another resident vendor who has either its headquarters or a principal business office in state four years prior to certification.
- The vendor has been a corporation non-resident vendor with an affiliate or subsidiary employing at least 100 state residents and has located its headquarters or a principal business office in state for four years prior to certification.

In order to apply for the second 2-1/2-percent of the Resident Vendor Preference, vendors must certify that they meet one of the following requirements:

- The vendor has been a resident, certifying that a minimum of 75 percent of its employees working on the contracted project have been West Virginia residents two years prior to bid submission.
- The vendor has been a non-resident, employing a minimum of 100 resident employees, or the vendor has an affiliate, subsidiary with headquarters or principal place of business in West Virginia that employs a minimum of 100 residents, who have lived in the

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*Resident Vendor Preferences are not applied among West Virginia resident vendors; they are only applied when out-of-state vendors compete against West Virginia vendors.*

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state for two years prior to bid submission, and continuously over the entire term of the contract, on average at least 75 percent of employees working on the contract have resided in the state for two years prior to bid submission.

Vendors who bid on state contracts are required to certify that they meet the residential and employer requirements for preferences at the time a bid is submitted. The Purchasing Division is not required to verify the information provided by the vendor in the certification unless a question is raised by another vendor bidding on the same contract. Under *West Virginia Code* §5A-3-37, the Department of Revenue is required to promulgate rules to establish a procedure to audit bids which make claim for vendor preferences. The Department of Revenue has not promulgated rules to establish a procedure to audit bids, but it has rules to investigate any certification that is questioned.

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*The Department of Revenue has not promulgated rules to establish a procedure to audit bids, but it has rules to investigate any certification that is questioned.*

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## **Vendor Preferences Affected a Relatively Small Percent of Contract Awards in FY 2008**

Currently, the Purchasing Division does not keep track of how many vendors certify that they meet the requirements of vendor preference or how often vendor preferences are applied. Consequently, the Legislative Auditor had to take a sample of awarded bids to estimate the frequency and impact vendor preferences have. The Legislative Auditor analyzed a random sample of Request for Quotations (RFQs) and all Request for Proposals (RFPs) for fiscal year 2008. For FY 2008, there were 1,026 RFQs totaling approximately \$464 million awarded to vendors and 13 RFPs totaling approximately \$44 million awarded to vendors.<sup>1</sup> The Legislative Auditor sampled five percent (51 contracts) of the RFQs issued for FY 2008, which had an approximate value of \$12 million. The sample consisted of open-ended contracts, statewide contracts, and general RFQs. Construction contracts are exempt from the Resident Vendor Preference and therefore were excluded for sampling purposes.

Bid tabulation sheets are used by Purchasing Division buyers during the evaluation process. They display the names of vendors who

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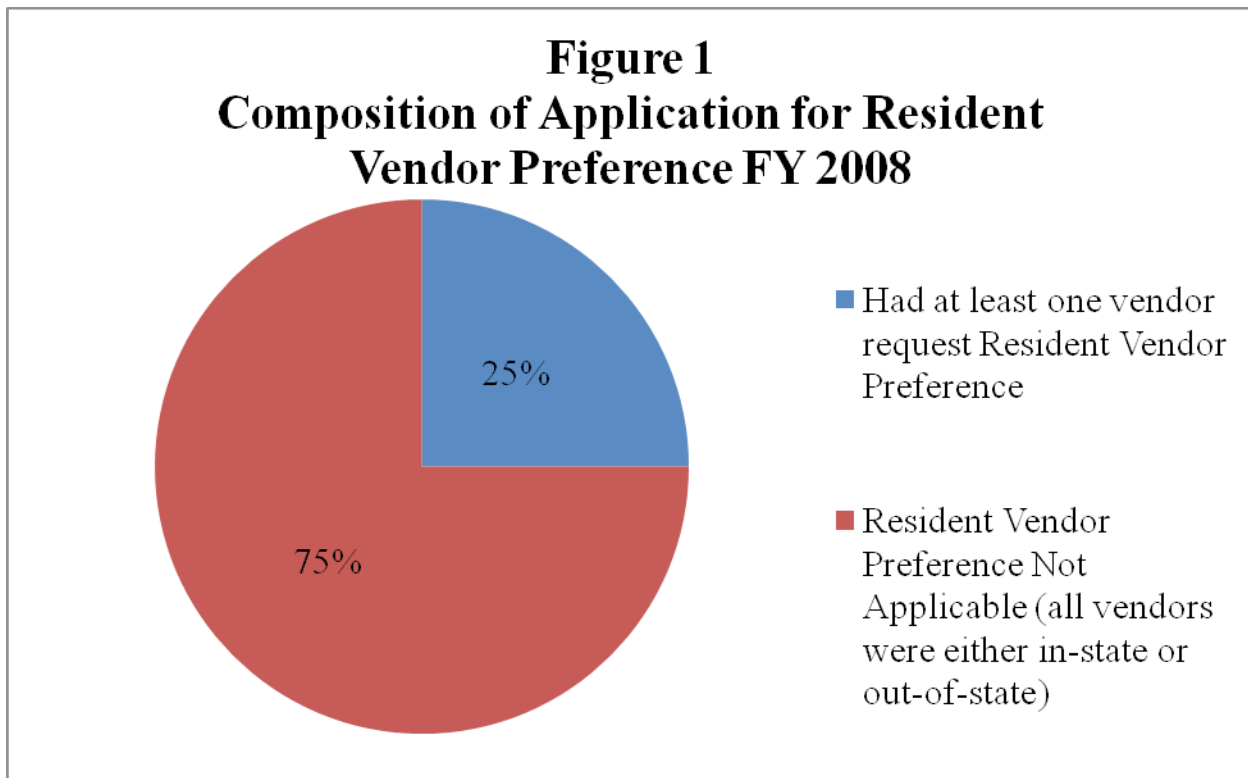
<sup>1</sup>Several RFQs were open-ended contracts, so the total monetary value of awarded contracts through RFQs in FY 2008 is likely higher than stated.

bid on the contract, the amount of each bid, and whether or not a vendor preference was applied. Figure 1 shows the composition of contracts that were sampled that involved competitive bidding. The Legislative Auditor found that of the 51 RFQ contracts reviewed, 13 bids (25 percent) had at least one vendor apply for the Resident Vendor Preference. The remaining 75 percent involved competitive bidding in which either in-state vendors were competing against other in-state vendors or out-of-state vendors were competing against other out-of-state vendors, which, in either case, would make the vendor preference non-applicable.

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*The Legislative Auditor found that of the 51 RFQ contracts reviewed, 13 bids (25 percent) had at least one vendor apply for the Resident Vendor Preference.*

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The Legislative Auditor found that of the 13 contracts awarded, 10 contracts were not affected by the vendor preference. Two of the 10 involved in-state vendors who requested the vendor preference but were the lowest bidders; therefore, the vendor preference was irrelevant. The remaining three contracts were for the Division of Highways that

involved multiple in-state and out-of-state vendors. It was noted that the in-state vendors requested the Resident Vendor Preference. However, these three contracts are relatively large, have purchases in various regions of the state, and involved many line items that were bid on; therefore, the Division of Highways maintained its own award data for these contracts. The Legislative Auditor was unable to determine if the Resident Vendor Preference affected any of the line-item awards made by the Division of Highway in these three contracts. If each of these three contracts involved vendors receiving contract awards through vendor preference, then the percentage of contracts that would have been affected by vendor preference would be at most 5.8 percent. However, without knowing the monetary amounts that may have been affected by vendor preferences in these three contracts, the Legislative Auditor is unable to extrapolate for the total population what is the total monetary value of contracts affected by vendor preferences. Therefore, the Legislative Auditor can only say that in FY 2008 the percent of contracts that were affected by vendor preferences was between 0 and 5.8% percent.

In addition, the Legislative Auditor reviewed all of the RFPs that were awarded for FY 2008, and found that no vendor bidding on an RFP had applied for the Resident Vendor Preference. Therefore, the Resident Vendor Preference did not change any contracts awarded as a result of RFPs in FY 2008.

## **Improvements Need to Be Made in the Administration of Vendor Preferences**

A review of the 13 contract awards that involved a vendor preference, only five of these had bid tabulation sheets showing a request for the vendor preference. Bid tabulation sheets record basic information concerning each vendor involved in the bidding. All 13 of the bid tabulation sheets should have reflected a vendor preference request. The five contract awards that had bid tabulation sheets that recorded the vendor preference request were administered appropriately. The Legislative Auditor reviewed the eight contract awards that had bid tabulations sheets that did not record the vendor preference request in order to determine if the vendor preferences were applied appropriately. The Legislative Auditor found that three of these eight contracts did not

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*The Legislative Auditor can only say that in FY 2008 the percent of contracts that were affected by vendor preferences was between 0 and 5.8% percent.*

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*The Resident Vendor Preference did not change any contracts awarded as a result of RFPs in FY 2008.*

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reflect that the vendor preference was applied when they should have been. In effect, the application for a Resident Vendor Preference was overlooked during the award process in these three cases (5.8 percent of the sample). The Legislative Auditor had the vendor preference applied in these three cases to see if it would have made a difference in who would have been awarded the contracts. The re-calculations showed that had the Purchasing Division applied the preference originally, it would not have changed the vendors to whom the contracts were awarded. During the time of this review, the Purchasing Division indicated that it was changing the bid tabulation sheet in order to more closely monitor the preference requests and applications, and to prevent similar mistakes from reoccurring.

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*The Legislative Auditor found that three of these eight contracts did not reflect that the vendor preference was applied when they should have been.*

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## **The Reciprocal Vendor Preference**

West Virginia has had a Reciprocal Vendor Preference since 1990; however, the Purchasing Division has not enforced this vendor preference in its contract award process. The language of *West Virginia Code §5A-3-37(a)* that establishes the Reciprocal Vendor Preference indicates that it is for vendors who have a physical presence in West Virginia, but currently do not meet the qualifications for the Resident Vendor Preference. Under the Reciprocal Vendor Preference, a vendor is deemed a resident of the state if the vendor:

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*West Virginia has had a Reciprocal Vendor Preference since 1990; however, the Purchasing Division has not enforced this vendor preference in its contract award process.*

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1. is in good standing under the laws of the state,
2. is a resident of the state or is a foreign corporation authorized to transact business in the state,
3. maintains an office in the state,
4. has paid personal property taxes on equipment used in the course of business, and
5. has paid business taxes according to the laws of the state.

The Reciprocal Vendor Preference gives preference to West Virginia vendors bidding against out-of-state vendors located in a state

with specific preferences for commodities or services. **This would only be applied if there was an out-of-state vendor bidding against a vendor who is a resident by definition of the Reciprocal Vendor Preference.** The reciprocal preference percent that would be applied is based on the out-of-state vendor's state preference laws. The preference amount is equal to the amount applied by the other state. For example, if another state gives its resident vendors a five percent preference on the purchase of a commodity, then West Virginia would apply this preference by increasing the out-of-state-vendor's bid by five percent. Of course, if the out-of-state vendor is from a state that does not have a vendor preference law, then the Reciprocal Vendor Preference would not apply in the bid process.

The Purchasing Division has indicated that the administration of the Reciprocal Vendor Preference is difficult due to frequent changes in vendor preference laws of other states. The Purchasing Division gave the following statement in regards to not enforcing the Reciprocal Vendor Preference:

*Reviewing and gaining detailed knowledge of every State's laws that relate to reciprocity would be exceedingly complex. Without legal staff to constantly research these laws, it would be extremely difficult to have sufficient accurate knowledge and comfort to make proper application of any reciprocity.*

West Virginia Code does not require any agency to promulgate rules regarding reciprocity. The Purchasing Division indicated to the Legislative Auditor that it would be beneficial if rules provided additional detail on how the Legislature prefers to make decisions on reciprocity.

The Legislative Auditor surveyed the contiguous states regarding the issue of vendor preference laws. The Legislative Auditor received responses from Kentucky, Ohio, Pennsylvania and Virginia.

- Kentucky does not have a vendor preference law.
- Ohio has a vendor preference law that recognizes a "border" state to be on the same footing as an Ohio bidder provided that the "border" state does not apply a preference against Ohio. **West Virginia's code indicates that a preference to West**

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*The Reciprocal Vendor Preference gives preference to West Virginia vendors bidding against out-of-state vendors located in a state with specific preferences for commodities or services.*

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**Virginia bidders is applied over Ohio bidders; therefore Ohio does not give West Virginia preference as a “border” state and does not recognize West Virginia as being on the same footing as other border states.** Therefore, West Virginia businesses are at a disadvantage in being awarded contracts in the state of Ohio.

- Pennsylvania has a vendor preference law that applies to supplies (including printing) for state procurements in excess of \$10,000. Pennsylvania resident bidders for state contracts exceeding \$10,000 receive preference.
- Virginia has a reciprocal vendor preference law that is similar to that of West Virginia, in that Virginia applies whatever preference is given by the other state to their out-of-state bidders. Virginia keeps an updated table that lists each state’s vendor preference laws.

Since the Purchasing Division is not enforcing the Reciprocal Vendor Preference, the Legislature’s goals of vendor preferences are not being met. Although the Legislative Auditor cannot determine the impact from the lack of enforcing this preference, it is possible that some contracts have been awarded to out-of-state vendors that may have been awarded to a company with a physical presence in the state if the preference was enforced. In order to achieve the goals of vendor preferences, the Legislative Auditor recommends that the Purchasing Division enforce the Reciprocal Vendor Preference as required by law.

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*Since the Purchasing Division is not enforcing the Reciprocal Vendor Preference, the Legislature’s goals of vendor preferences are not being met.*

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*In order to achieve the goals of vendor preferences, the Legislative Auditor recommends that the Purchasing Division enforce the Reciprocal Vendor Preference as required by law.*

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## **The Veterans Resident Vendor Preference**

The Veterans Resident Vendor Preference gives preference to veterans who wish to bid on state contracts. The veterans must certify that they meet one of the following requirements:

- The vendor has been an individual resident who is a veteran and resided continuously in state for four years prior to the bid submission.
- The vendor has been a resident veteran vendor employing a

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*The Veterans Resident Vendor Preference gives preference to veterans who wish to bid on state contracts.*

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minimum average of 75 percent of in-state employees residing for at least two years prior to bid submission.

The Veterans Resident Vendor Preference gives a 3-1/2-percent preference to certifying veterans. The 3-1/2-percent increases the out-of-state vendor's bid during the evaluation process. **The Legislative Auditor's sample of both RFQs and RFPs found that no vendor applied for Veterans Resident Vendor Preference in FY 2008.**

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*The Legislative Auditor's sample of both RFQs and RFPs found that no vendor applied for Veterans Resident Vendor Preference in FY 2008.*

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## Conclusion

The Legislative Auditor found that while the State has three vendor preferences, only two are actually applied during the competitive bidding process by the Purchasing Division. It was also found that in competitive bids in which the Resident Vendor Preference was requested, three of these cases (23 percent of those who requested the preference) the Purchasing Division inadvertently did not apply the vendor preference. Fortunately, in these cases the correct vendor received the award despite the error. Overall, the Legislative Auditor estimates that the five percent preference limit provided by statute may have affected between 0 and 5.8 percent of state contracts in FY 2008. However, the total monetary amount that may have been affected could not be estimated. If it is the Legislature's goal to award more contracts to in-state vendors, then the Resident Vendor Preference at the current percents does not meet this objective. If the 5 percent preference limit was were increased to 10 percent, the Legislative Auditor found that two contracts that were awarded to out-of-state vendors would have been awarded to in-state vendors. The awarded contracts totaled approximately \$11,566 within the sample. When this is extrapolated to the total universe of state RFQ contracts awarded in FY 2008, the amount that would have been awarded to in-state vendors is estimated at \$448,000. However, this would be a minimum amount and it could be higher if the Legislative Auditor could apply the same analysis to the three contracts administered by the Division of Highways.

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*Overall, the Legislative Auditor estimates that the five percent preference limit provided by statute may have affected between 0 and 5.8 percent of state contracts in FY 2008.*

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*The lack of enforcement of the Reciprocal Vendor Preference by the Purchasing Division undermines the Legislature's objective in establishing this preference.*

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The lack of enforcement of the Reciprocal Vendor Preference by the Purchasing Division undermines the Legislature's objective in establishing this preference. The Legislative Auditor cannot determine the value of contracts that were awarded to out-of-state vendors that would



have been awarded to in-state vendors if this preference was enforced. The preference may also have a similar impact as the Resident Vendor Preference. Nevertheless, the Purchasing Division should enforce this preference or inform the Legislature of its concerns.

## **Recommendations**

- 1. The Purchasing Division should comply with West Virginia Code §5A-3-37a, which is the establishment of the Reciprocal Vendor Preference or inform the Legislature of its concern.*
- 2. The Purchasing Division should improve its administration of vendor preferences to avoid inadvertent omissions that result in eligible vendors not receiving preference.*

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*Nevertheless, the Purchasing Division should enforce this preference or inform the Legislature of its concerns.*

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## Appendix A: Transmittal Letter

### WEST VIRGINIA LEGISLATURE *Performance Evaluation and Research Division*

Building 1, Room W-314  
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John Sylvia  
Director

February 6, 2009

David Tincher, Director  
West Virginia Purchasing Division  
2019 Washington Street, East  
Post Office Box 50130  
Charleston, West Virginia 25305-0130

Dear Mr. Tincher:

This is to transmit a draft copy of the study conducted as a result of House Concurrent Resolution Number 88 reviewing Vendor Preferences. This issue is scheduled to be presented on February 10, 2009 at noon in the House Chamber during the interim meeting of the Joint Committee on Government Operations and the Joint Committee on Government Organization. It is expected that a representative from your agency be present at the meeting to orally respond to the report and answer any questions the committees may have.

You are not required to respond in writing, but please feel free to respond if you wish. We request that your personnel not disclose the report to anyone not affiliated with your agency. Thank you for your cooperation.

Sincerely,

A handwritten signature in cursive script that reads "John Sylvia".

John Sylvia

Enclosure  
c: Robert W. Ferguson, Jr., Cabinet Secretary

\_\_\_\_\_ *Joint Committee on Government and Finance* \_\_\_\_\_



## Appendix B: Agency Response



JOE MANCHIN III  
GOVERNOR

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February 9, 2009

Mr. John Sylvia  
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RECEIVED  
FEB 09 2009

PERFORMANCE EVALUATION AND  
RESEARCH DIVISION

Subject: Post Audit Response

Dear Mr. Sylvia:

We are in receipt of your letter, dated February 6, 2009, transmitting a draft copy of the study conducted by your office relative to House Concurrent Resolution Number 88 reviewing Vendor Preferences.

After reviewing this draft copy, the Purchasing Division agrees with the findings and recommendations provided. During the audit, it was noted that some inconsistencies were discovered with the file documentation, evidencing consideration of vendor preference. Since the audit was conducted, the bid tabulation form used by our buying staff was modified and the revised format was immediately implemented to resolve this problem in the future.

Actions are currently being taken to implement the recommendation to comply with §5A-3-37a, reciprocal Vendor Preference.

Thank you for your recommendations. You may be assured we will work diligently to correct any deficiencies found by your office.

Very truly yours,

Karen Byrd, Assistant Director  
Purchasing Division

Cc: Robert W. Ferguson, Jr., Cabinet Secretary  
David Tinchler, Director, Purchasing Division





WEST VIRGINIA LEGISLATIVE AUDITOR

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