

MINUTES
SENATE FINANCE COMMITTEE
March 24, 2006
9:05 a.m.

CALL TO ORDER

Co-Chair Lyda Green convened the meeting at approximately [9:05:37 AM](#).

PRESENT

Senator Lyda Green, Co-Chair
Co-Chair Wilken, Co-Chair
Senator Bunde, Vice-Chair
Senator Donny Olson
Senator Lyman Hoffman
Senator Bert Stedman

Also Attending: DAVE STANCLIFF, Staff to Senator Gene Therriault; SCOTT HAWKINS, General Manager, Alaska Supply Chain Integrators LLC; BARRY JACKSON, Procurement and Contracting Manager, Alaska Supply Chain Integrators LLC; DON PETERSON, Senior Manager, Mikunda Cottrell Accounting & Consulting (MCAC), VERN JONES, Chief Procurement Officer, Division of General Services, Department of Administration; ART CHANCE, Director, Labor Relations, Division of Labor Relations, Department of Administration; MARK O'BRIEN, Chief Contracts Officer, Division of Contracting, Procurement and Appeals, Department of Transportation and Public Facilities

Attending via Teleconference: From an offnet site: Dr. OLIVER HEDGEPEETH, Logistics Professor, University of Alaska

SUMMARY INFORMATION

SB 284-SENTENCING FOR ALCOHOL-RELATED CRIMES

The bill reported from Committee.

Electronic Commerce Pilot Program Overview Presentation

The Committee conducted an oversight hearing in regards to the State's Electronic Commerce Pilot Program. Remarks were provided from representatives of Alaska Supply Chain Integrators, LLC; Mikunda Cottrell Accounting & Consulting; a logistics professor with the University of Alaska; the Division of General Services, Department of Administration; the Division of Labor Relations, Department of Administration; and the Division of Contracting, Procurement and Appeals, Department of Transportation and Public Facilities.

#sb284

CS FOR SENATE BILL NO. 284(JUD)

"An Act relating to sentencing for the commission of a felony while under the influence of alcohol."

This was the second hearing for this bill in the Senate Finance Committee.

Co-Chair Green noted that CS SB 284(FIN), Version 24-LS0581\L, was before the Committee.

DAVE STANCLIFF, Staff to Senator Gene Therriault, the bill's sponsor, was available to answer Committee questions.

There being none, Co-Chair Wilken moved to report the bill from Committee with individual recommendations and accompanying fiscal notes.

Without objection, CS SB 284(FIN) was REPORTED from Committee accompanied by previous indeterminate fiscal note #1 from the Office of Public Advocacy, Department of Administration; indeterminate fiscal note #2 from the Public Defender Agency; a new indeterminate fiscal note dated March 8, 2006 from the Alaska Court System; and a new indeterminate fiscal note dated March 23, 2006 from the Department of Corrections.

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[9:06:56 AM](#)

^Electronic Commerce Pilot Program Overview Presentation

Electronic Commerce Pilot Program

Overview Presentation

[9:08:23 AM](#)

SCOTT HAWKINS, President and Chief Operating Officer, Alaska Supply Chain Integrators, LLC (ASCI), the State's procurement agent, thanked the Committee for holding this "oversight hearing" on the status of the Electronic Commerce Pilot Procurement Program (PPP) to date. The findings of a Department of Administration "State of Alaska Division of General Services Cost of Goods Analysis" (Study) [copy on file], prepared by Mikunda Cottrell Accounting and Consulting, would be addressed in conjunction with ASCI's "insights and perspectives on the Program" as depicted in an ASCI handout titled "ASCI State e-Commerce and Supply Chain Management Program An Important Precedent", [copy on file] dated March 23, 2006. Mr. Hawkins reviewed the ASCI handout as follows.

Page 2

Presentation Overview

- About ASCI
- State Pilot Procurement Program:
 - *Background
 - *MCAC/State Cost of Goods Study
 - *Overall Performance
- Why It Matters

Mr. Hawkins overviewed the points the presentation would address.

Page 3

ASCI Corporate Profile

- Established 1999
- Alaska LLC; Majority Alaskan Owned
- Employees: ~ 160

Mr. Hawkins noted that this "young" company is headquartered in Anchorage and is primarily owned by Alaskans.

Page 4

What ASCI Does

- Full Range of Supply Chain and Related Technology Services
- Overview at www.asci4materials.com
- Other Services:
 - *Maintenance planning
 - *Catalog data control and conversion
 - *Web site & web tool development
 - *Inventory optimization services

Mr. Hawkins reviewed the information on this page. The majority of ASCI's "supply chain management services are very broad and complete full cycle services" primarily in support of Alaskan companies. ASCI began its operations in 1999 with 35 employees. Today it employs 160 people with the anticipation of having 175 employees by year-end.

Page 6

Who We Serve

BP Alaska

- Full cycle supply chain management
- Web technology
- Maintenance planning and special projects

Exxon Mobil

- Web technology

Shell E&P

- Web technology

State of Alaska

- Began in 2004
- Full cycle supply chain management
- Web technology

Neal and Massey

- Trinidad Joint Venture
- Full cycle SCM

Mr. Hawkins overviewed ASCI's customer base; its largest customer is British Petroleum (BP). While ASCI was initially structured to provide services required by BP, it has expanded to providing Internet technology services to other oil companies and, approximately one and a half years ago, began providing supply chain management services to the State of Alaska. It recently established a joint venture in Trinidad in anticipation of providing services to entities involved with that country's developing oil field.

Page 7

Performance Based Approach

1. Balanced Performance Scorecard
2. Heavy Emphasis on Measurements
 - Strong analytical capabilities
 - Drives process management, improvement
3. Vendor Scorecard Management
 - Web based tools

Mr. Hawkins stressed the importance ASCI places on performance and performance measurements. The primary evaluation tool is a measurement-based scorecard "with our customers". The company's "profitability is tied to our measurable performance" on a variety of performance indicators, including cost of goods measurement. Due to the emphasis placed on accountability, ASCI has "very very strong analytical capabilities". Due to the emphasis on this structure, it is doubtful there are many companies in the world that could match "the amount of expertise that we have developed around measurements of the supply chain management process". No entity in Alaska could compete with ASCI's expertise in cost of goods measurements in this field.

[9:12:18 AM](#)

Mr. Hawkins shared that ASCI also "intensively" measures the vendor industry. To that point, the narrow scope of ASCI's procurements for the State of Alaska has limited this endeavor. However, in its work for BP and other entities, ASCI maintains scorecards on its "top 50 vendors". Those vendors also have internal "balanced scorecard" performance measures, which are reviewed regularly with ASCI in an effort to manage vendor performance. The ability to manage vendor performance is another of the performance indicators ASCI adheres to. Vendors

appreciate the "collaborative performance management relationship".

Page 8

SOA "Pilot" Program

[ASCI provided the cost comparison chart depicted on this page to the State in its 2004 proposal. The data projects that ASCI's 2006 services would produce a savings of \$251,882 or 38 percent over 2003 State of Alaska (SOA) Procurement and Warehouse Operations.]

- HB 313, 4 agencies, Cost Study, RFP Process
- Cost savings on administration only, not prices
- Scope: goods and services
- Scalable platform for expansion.

Mr. Hawkins reminded that HB 313 authorized PPP in 2003. It pertained to four agencies, two departments, and two other instrumentalities of the State. The Request For Proposal (RFP) process proposed by ASCI had been adopted. The scope of PPP included both goods and services, thus expanding ASCI's scope of business from its previous concentration on goods contracting. PPP also mandated the "installation" of an expandable e-Commerce program.

Page 9

Program Framework

- Pilot agency: DOT/PF Southeast Region
- 11 person operation (12 w/ mgr)
- Full e-Commerce system installed, integrated w/ 2 systems, customized, trained
- Two years operating time to sunset
- Emphasis on overhead cost savings, staff reductions (became 6-7 person operation)
- One-day operational transition

Mr. Hawkins reviewed the information on this page. The RFP emphasized overhead cost savings; little emphasis was placed on the cost of goods. Additional cost of goods language was added

by request of ASCI, as they viewed the original emphasis placed on that element as insufficient.

Mr. Hawkins recounted there being a one-day transition in the implementation of PPP. Existing SOA procurement personnel departed on July first and ASCI employees assumed responsibility on July second.

Page 10

Some Basic Challenges

- a. Location and workforce (Juneau)
- b. "Hard" transition (peak season)
- c. Specialized nature of AMHS customer
- d. Multiple computer systems to integrate
- e. Short time frame to achieve cost savings
- f. Extremely limited transition assistance
- g. Quarterly "benchmark audits"
- h. Undisclosed baseline staffing
- i. Disconnect between the representations and the reality of "Administrative support"

Mr. Hawkins stated that of the numerous challenges ASCI faced during its transition into PPP, having to establish a workforce in Juneau was very challenging, particularly as ASCI is headquartered in Anchorage. The July transition time was quite hectic specifically as that is one of the busiest times for the Alaska Marine Highway System (AMHS), which is one of the entities in the Program.

Mr. Hawkins also noted the SOA is a "very specialized customer", as evidenced by the fact that AMHS needs are very unique. ASCI was on a "vertical learning curve in the busiest season of the year". The computer information technology (IT) interfaces were very complex to develop. Such things as integrating a maintenance program and a password validation program added to that complexity.

Mr. Hawkins affirmed that while many of the transition challenges were known as they were specified in the RFP, there were some surprises. The RFP impressed how supportive and committed the Administration was of the Program. However, when ASCI assumed its role with the Southeast Region of the Department of Transportation and Public Facilities, "that

commitment did not appear to extend to the operating agency". Further discussion on this issue would be forthcoming.

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Senator Bunde pointed out that, "change is challenging and threatening for us all". However, he asked whether Mr. Hawkin's remarks were to imply "the change was resisted and perhaps structured to make it difficult for your operation to be successful".

Mr. Hawkins responded "yes". A combination of things might have influenced the situation. As PPP was new to the State, "some innocent but not particularly helpful decisions and judgments that were made, made it extremely difficult." Upon ASCI's "arrival at the agency, the misjudgments gave way to outright hostility".

Mr. Hawkins informed the Committee the Anchorage Daily News newspaper recently printed an article [copy not provided] on the Study that had been conducted by the Anchorage firm of Mikunda Cottrell Accounting and Consulting (MCAC) on behalf of the Division of General Services, Department of Administration. ASCI's procurement contractor manager, Barry Jackson, would provide ASCI's and another independent consulting firm's "view" of that study.

9:19:16 AM

Page 11

Cost of Goods Study

- MCAC reported 9% increase
- Based on "sample" of 167 transactions matched through manual data sifting
- Summed unit prices of items, compared sums
- Attempted to ignore freight
- Inflation not considered

BARRY JACKSON, Procurement and Contracting Manager, Alaska Supply Chain Integrators, stated the MCAC Study reported a nine percent increase in the cost of items purchased by ASCI as compared to the cost of identical items purchased by SOA procurement staff. That was based on a sample of "only" 167 transactions out of more than 40,000 transactions "that were

matched through manual data sifting. The unit prices of the items that were selected were summed up to a total and those sums were compared between the State's former buyers and ASCI's approach".

Mr. Jackson noted the Study specified "the desire to avoid freight costs as an issue". In addition, while acknowledging its importance, inflation was also not considered in the Study's conclusions.

Page 12

Two Independent Reviews

- Altman Rogers and Co., Certified Public Accountants
Reviewed For Errors, Comparability, Quantity
Weighting, Price adjustments, Freight Terms,
Overall Validity
- Northern Economics, Inc.
Reviewed Methodology, Statistical Soundness,
Inflation Adjustment

Mr. Jackson recounted that after reviewing the Study and determining there were inaccuracies, ASCI conducted its own analysis. When ASCI "attempted" to discuss various issues with the State, they were informed that any discussion about the MCAC Study would only occur after ASCI "hired its own experts" and conducted "their own studies".

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Senator Bunde asked who with the SOA had informed ASCI "that they chose not to cooperate".

Mr. Jackson communicated that this directive came from two individuals: Mark O'Brien with the Department of Transportation and Public Facilities and Vern Jones, Chief Procurement Officer, Department of Administration.

[9:21:51 AM](#)

Senator Bunde asked whether the reason for their not seeking "further clarification" was disclosed.

Mr. Jackson disclosed the stated reason as being, "out of fairness" to MCAC, ASCI must conduct its own study. Therefore, ASCI hired Altman, Rogers & Co. Certified Public Accountants and Northern Economics Inc. The companies' review responsibilities were outlined.

Page 13 Conclusions of Reviews

- MCAC/State Study Found Invalid and Uncorrectable
- Identified At Least 9 Critical Deficiencies
 - *Critical Clerical/Invoice Errors (ARC)
 - *Critical Item Comparison Errors (ARC)
 - *Failure To Use Equal Freight Comparisons (ARC)
 - *Failure To Treat Alaska Vendor Freight Correctly (ARC)
 - *Failure To Use Actual Purchased Quantities (ARC)
 - *Failure To Adjust For Inflation (NE)
 - *Failure To Achieve a Random Sample (NE)
 - *Failure to Use Statistics in Any Way (NE)
 - *Invalid Extrapolation Of Data (ARC, NE)

Mr. Jackson discussed the conclusions of Altman, Rogers & Co and Northern Economics Inc. reviews outlined on this page. Some of the items being compared were not identical and some did not include "equal freight comparisons", as the price of an item purchased by ASCI might have included freight while the price of the same item purchased by SOA did not.

Mr. Jackson also questioned the comparisons of items purchased through Alaska vendors, as, oftentimes, the freight charges included in their prices were not properly accounted for when compared to outside vendors. Furthermore, there was concern about the actual consideration of unit price costs. Quantity considerations are "important": were ASCI to negotiate a one dollar per unit purchase price and SOA a two dollar unit price, ASCI would generate a savings of one dollar on a single item purchase. However, were ten units purchased, the savings would be ten dollars.

Mr. Jackson was surprised the MCAC Study did not include inflation adjustments; particularly as procurement comparisons included items purchased up to 27 months apart.

Mr. Jackson stated the MCAC Study did not include statistics "in any way" even though the Study "required statistically valid sample pools".

Mr. Jackson expressed concern in regard to the extrapolation of data as the 167 goods and services items, which amounted to several thousand dollars, were "extrapolated to a spend of eleven million dollars". Since the MCAC Study only included goods, "a sizeable portion of that extrapolation is simply invalid".

Page 14

Impact of the Errors

- Using MCAC's Invalid Methods, But With Known Errors Corrected/Excluded:

*ASCI Saved 3.6 % (\$244,800) On Costs Of Goods

- ASCI Saved State Additional \$187,000 On Procurement Operations
- Total Savings To State: \$431,800

Mr. Jackson specified that when ASCI corrected "as much as" it could of MCAC's invalid methodology, a cost of goods savings of 3.6 percent resulted as opposed to the MCAC determination that ASCI lost the State "a million dollars". This combined with the savings generated by ASCI's administration of PPP indicated a total savings of \$431,800. He reiterated that even this should not be considered "a valid number", as it was based on an effort to correct the invalidities of the MCAC Study.

Mr. Jackson declared that one of several reasons the MCAC Study was "so bad" was because the Study was "manipulated". To support this position, he read excerpts of an August 25, 2006 letter [copy on file] he had received from Tom Mayer, Contracting Officer, Division of General Services, Department of Administration, in response to questions he had asked.

Does the State yet know exactly how MCAC intends to determine a sample size that will be statistically valid?

- No, the state does not know how this will be determined. As professionals in the field, MCAC will

independently determine a statistically valid sample size.

Does the State know how MCAC will determine the constituents of the sample and maintain statistical validity?

- No, MCAC will determine the samples and create a statistically valid pools.

Will the report include alternative credible explanations for the report result?

- The analysis report will be created and developed by MCAC. However, as indicated in the meeting notes referenced above, MCAC is aware of variables such as differing quantities, delivery dates, requirement time frames, and price increases in the market place. The state also discussed the application of a CPI adjustment or other price adjustment indices in appropriate circumstances.

Will the report include a discussion of potential market conditions and other factors that could affect the results, for each item selected for inclusion in the report?

- Report development is the responsibility of MCAC.

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Mr. Jackson interpreted the Department's responses to clearly indicate they would allow MCAC to manage the Study; "the State would have little to do or say with it".

Mr. Jackson conveyed ASCI's reaction to the MCAC Study was that "several things were missing from it". MCAC "clearly" did not do the things identified in Mr. Mayer's letter or as specified in the RFP establishing the Study contract.

Mr. Jackson initially thought ASCI was unaware of changes made to the contract. Thus, the Division of General Services was asked to provide further information in that regard. A stack of paper consisting of 1,040 pages "of communications between MCAC and the State" was displayed as the response to that question.

Not "exactly what you would expect from an independent evaluation".

Mr. Jackson described the communications: "the Division of General Services (DGS) directed the consultant to use methodologies and calculations invented by General Services; they allowed the consultant to avoid using certain repetitive data such as liquor and beer because it was too hard to compare; DGS managed a narrative discussion of the Study in certain ways; DGS committed certain errors of omission by not requiring things that they said they were going to require." Through this manner, "DGS actively managed the results toward an outcome that coincidentally disfavored ASCI". The implication was that DGS was interested in including things that "raised the cost of goods conclusions" and omitted things that could have lowered those conclusions.

Mr. Jackson noted there being additional factors such as "bad will".

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In order to further explain this remark, Mr. Jackson shared that he had retired from the State DGS after 30 years of employment. During his career with DGS, he was responsible for actions "to improve the efficiency" of the Division, including developing programs to automate the purchasing system. He had worked with Vern Jones, DGS's Chief Procurement Officer. After retiring from DGS, he worked as a programmer for Resource Data. It was during this time the RFP for this Program was released. Resource Data asked him to assist ASCI in their effort to respond to the RFP. Subsequently, he worked as a consultant to ASCI before joining them fulltime, as the objectives of the Pilot Procurement Program were "near and dear to my heart".

Mr. Jackson credited his employment with DGS as the reason SOA employees "dealt" with him "more candidly" than they might have dealt with others. To substantiate his "bad will" remark, he shared that during a conversation with Mark O'Brien with the Department of Transportation and Public Facilities (DOT), he asked Mr. O'Brien "how DOT had measured cost of goods on itself in the past". The response was "we didn't, we never have, and I don't expect we ever will". Thus, Mr. Jackson questioned why this was considered important in regards to ASCI. Mr. O'Brien responded that Mr. Hawkins' testimony before the Legislature

"that his program could save more money than State employees could on the cost of goods ... hurt our feelings. Because of that ... we're going to hold his feet to the fire."

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Mr. Jackson interpreted this as "bad will". Similar but "not as blatant" discussions occurred with Vern Jones. Such actions would undermine the "promises" Scott Hawkins made to the Legislature.

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Mr. Jackson stated that forcing ASCI "to spend tens of thousands of dollars" to develop its own study in order to talk to DGS was further evidence of bad will. That discussion has yet to occur.

Mr. Jackson opined that another factor in the discussion is one of "incompetence." He continued, "the folks in General Services are seasoned pros who knew better. They failed to challenge their expert. It's beyond comprehension that they would allow a report like this to get out with no adjustments for inflation, without dealing with freight inequalities, and leaving quantities out of the picture. They knew better and yet they let it happen."

Mr. Jackson determined that, due to "inexperience" the State did not know what they were doing, in the sense that "the State has never and would never try to measure its savings in this manner".

Mr. Jackson recalled the State having measured "its own savings in entirely different way. That method virtually never shows a loss in procurements".

Mr. Hawkins remarked "this brings us back to the question of overall performance".

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Mr. Hawkins reaffirmed his testimony "that there is tremendous cost of goods savings potential in the program". However, those savings could not occur simply by changing procurement personnel. "Full deployment of all of the infrastructure that is designed to deliver that cost of goods savings" must occur.

Absent the ability to combine volumes with other agencies, a small procurement office, particularly when dealing with such entities as the AMHS which has specialized purchases from single source vendors, would require additional time to show cost of goods savings. The ability to develop catalogs and secure vendor agreements would be difficult to accomplish in a short period of time, particularly under "an RFP that is designed to maximize administrative overhead cost savings". The mechanics of PPP are not "designed to deliver cost of goods savings".

Mr. Hawkins stated that cost of goods comparisons, the information gleaned from reviewing the MCAC Study, and other data, the indication is that ASCI "is doing about as well, maybe a little better than" its SOA predecessors.

Mr. Hawkins praised the knowledge possessed by ASCI in the field of cost of goods savings. Its professional procurement staff delivers "millions of dollars" of cost of goods savings to its customer base each year.

Page 15

Performance Categories

1. Cost of Operations
2. Workload Comparison
3. Processing Time
4. Alaska Vendor Usage
5. Cost of Goods

Mr. Hawkins opined that ASCI is "the most scrutinized and measured procurement office in the history" of the State. ASCI is subject to a DGS quarterly measurement and metrics performance standard consisting of the five performance categories reflected on this page.

Page 16

[The three charts on this page compare the labor costs experienced by ASCI in 2005 to those experienced by the SOA in FY 2004; the labor costs per purchase order for the SOA in FY 2004 to those of ASCI in FY 2005; and procurement and warehouse Operations Staffing of SOA in FY 2004 to ASCI for 2005.]

In calendar year 2005, ASCI invoiced the State of Alaska \$125,000 less than it had spend on staffing in FY 2004. This is a cost reduction of 20%, and does not include reduced office space needs, telephones, computers, supplies, etc.

ASCI uses 4.5 people to do procurement office work previously done by 8 - not including the previous manager.

In 2Q FY 2006 (calendar 4Q '05), purchasing workload was up sharply with no staff increase. This put cost per transaction 40% lower than 2Q FY 2004, indicating very strong program expansion economics.

Data Sources: State quarterly "benchmark audits", State baseline data, ASCI invoice data.

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Mr. Hawkins reviewed the information on this page. Staff costs per transaction have decreased under ASCI from \$85 to \$51 per purchase order line: a 40 percent reduction.

[9:42:30 AM](#)

Page 17

Workload Comparison - Calendar 2005

Purchase Orders and Warehouse Issue Transactions

[This graph depicts Calendar year 2005 workload percent increases from FY 04 on a quarterly basis. First quarter increase was 15 percent, second quarter was five percent, third quarter was 12 percent; fourth quarter was 24 percent for an average increase of 13 percent.]

Mr. Hawkins communicated that ASCI has no control over workload levels. "The work comes to us." The information substantiates the fact that ASCI has been able to manage the increasing workload.

Page 18

Requisition Process Time Comparison FY 2005

[This chart depicts the medium and average process time by elapsed days comparisons between the State in 2003-2004 and ASCI in 2005. Both entities' medium process time was two days with an average of 5.1 days for the State and 4.8 days for ASCI.]

Requisition Process Time Comparison 2Q 2006

[This chart compares, by Elapsed Days, the medium and average process time for the State in the second quarter of 2004 to ASCI's second quarter 2006 process times. The State's medium process time was two days and ASCI's process time was one day; the State's average process time was 4.4 days as compared to ASCI's 4.1 days.]

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Mr. Hawkins reviewed the information on this page. Even with a lower staff count and increasing workloads, ASCI was able to handle the workload. ASCI must adhere to a new requirement not generally required of previous State procurement employees: any item exceeding \$2,500 must receive "specific not to exceed budget authority". Were a procurement to exceed that authority, ASCI must contact and receive authority from the approver. Nonetheless, ASCI was able to obtain a decrease in requisition processing time. ASCI's processing time has decreased over time.

[9:46:34 AM](#)

Page 19

Process Days - SOA Employee SmartTools Requests

[This graph depicts the decrease in processing days that is experienced by those State employees using the ASCI Webtools system.]

Mr. Hawkins explained that ASCI's Webtools catalog system has allowed State employees to place and receive approval of their requisitions and then submit them to ASCI. While most orders are now processed in this manner, getting to this point "was a long haul". In the fourth quarter of 2004, State employees using the Webtools requisition system experienced approximately a four-day processing timeframe; that was "quickly" reduced to a one-day

processing time; and today, "orders placed on the web procurement platform" were "getting out same day" more than half the time. The speed is increasing.

Mr. Hawkins shared a communiqué ASCI recently received from a state employee on a vessel: "I know you guys get a hard time ... but I just want to say that I've really seen speed differences. I'm looking at a pair of boots that I ordered just a couple of days ago and I can't believe they've already showed up here."

Mr. Hawkins clarified not all requisitions are received via Webtools. In addition, there are some "inherent" issues within the AMHS that make the implementation of the Webtools system "more challenging" than most State agencies. Nonetheless, ASCI is continuing to work on implementing the system.

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Co-Chair Wilken asked whether ASCI developed the Smarttools program and whether British Petroleum and other ASCI clients also utilized it.

Mr. Hawkins affirmed the electronic commerce (eCommerce) technology was developed to further ASCI business practice processes. Such a program is invaluable to a supply chain management company. The Smarttools program is on par with other internationally used programs.

[9:49:29 AM](#)

Page 20

Percent Orders to Alaska Vendors

[This graph indicates 58.3 percent of the vendors utilized by the State in FY 04 were Alaska vendors. Alaskan vendors amounted to 63.6 percent of ASCI's vendors in FY 2005 and 68.6 percent in FY 2006.]

Percent Order Value to Alaska Vendors

[This graph reflects that Alaska vendors received 47.3 percent of the order values placed by the State in FY 2004. 53.2 percent and 59.0 percent of the order values placed by

ASCI in FY 2005 and FY 2006, respectfully, were to Alaska vendors.]

Mr. Hawkins noted another accountability measure built into ASCI's performance benchmark by the State is its use of Alaska vendors. He reminded the Committee about Mr. Jackson's earlier concern about how the cost of goods secured from Alaska vendors could be distorted by the manner in which freight cost is accounted for.

Mr. Hawkins noted this page reflects the percentage of the orders and the percentage of the values spent with Alaska vendors. In summary, ASCI spent \$690,000 more dollars with Alaska vendors than the State had previously spent.

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Mr. Hawkins stressed the pride and effort taken by ASCI "to form service relationships with Alaska vendors". The economic benefits resulting from such relationships include the fact that Alaskan vendors manage freight charges better and would have goods and supplies on hand. This would increase service levels, particularly in Southeast Alaska.

Page 21

More Performance Indicators

- Fully functional e-Commerce system
- Tailored to SOA needs, integrated
- Deployed with users, vendors
- 5000 item catalog
- Inventory reduction (office supplies)
- Customer feedback log
- Private sector performance management
- High priority order (P1) status log
- "Large" procurements log

Mr. Hawkins outlined this information. The customer feedback log is reviewed and, combined with the private sector performance management tool information, is "used as a management tool to make needed changes". The changes enacted have served to produce "high morale amongst staff even though they are up against a lot". "That sense of being against all odds and pulling together as a team" contributes to company morale.

Mr. Hawkins shared that ASCI maintains a priority one, two, and three expediting process. High priority orders are tracked in systematic manner. Other management tools are also used.

[9:53:57 AM](#)

Page 22

Just a Few Examples of "Dirty Tricks"

- Zero transition assistance
- Failure to stop or overcome sabotage
- Internal group formed during first month to accumulate evidence for contract termination
- Misinformation campaign from beginning
- Concealment of baseline staffing
- Interference in employee relations
- Failure to issue timely web ordering procedures
- Regular "fishing" for complaints
- Double standards on operations and metrics
- Unilateral changes in contract deliverables
- Interference in "independent" studies

Mr. Hawkins pointed out that with all the positive things that have occurred, you would anticipate "positive feedback from the agencies" involved with PPP. This is not the case. None of ASCI's performance accomplishments have been acknowledged. "The response has been stone silence, and in fact the response has been just the opposite." The "litany of ... bureaucratic dirty tricks have occurred, designed to sweep the good performance picture under the rug, highlight any bad performance that can be documented, and discredit the program."

Mr. Hawkins stated that the list of examples depicted on this page is not inclusive. There was no transition assistance and in fact, when ASCI entered the office for the first time, the cubicles were not set up, the office chairs were "the worst in the building", and the ink cartridges in the computer printers were empty. "Little was done to ease" the ASCI staff's transition into the operation.

Senator Bunde, considering "the word sabotage ... as a very strong word", asked Mr. Hawkins for further "elaboration".

[9:56:24 AM](#)

Mr. Hawkins characterized SOA actions as "petty sabotage". Vendor lists, fax cover sheets to vendors, Rolodex information including phone numbers and names "had been destroyed". Warehouse staff "refused to show" ASCI employees the system, refused to show them how the existing inventory process worked, and how inventory transactions were processed. DOT management "did nothing to stop" that behavior. The logbooks that recorded the number of service trips the warehouse staff made to the Auke Bay Ferry Terminal and to the Lemon Creek Correctional Facility to exchange out laundry were hidden, and thus important scheduling information was unavailable to ASCI staff. Nonetheless, ASCI persevered and eventually overcame such actions.

Mr. Hawker reiterated DOT management's lack of assistance in addressing the petty sabotage. In the first few weeks of taking responsibility for procurement for DOT, ASCI was told by employees "that they thought it was wrong; that an internal group had been formed under the auspices of Nancy Slagle [Director, Division of Administrative Services, Department of Transportation and Public Facilities] to accumulate evidence and documentation on how to discredit the program." The [unidentified] Contract Manager "who was supposed to smooth the transition" told ASCI that he felt "this was a bad idea and that this group had been formed to try to put a stop to it."

Mr. Hawker stated there was misinformation from the beginning of PPP. Minor growing pains and other normal occurrences were blown out of proportion. Any compliments directed at ASCI services were viewed as being "undeserved". The aforementioned incidents were some of the things that occurred at the onset of ASCI's involvement. Unfortunately, the negative behavior "is not abating", and could even be viewed as "intensifying" as PPP's termination date nears.

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Mr. Hawkins opined that SOA reasoning could be "the time is now to kill it if it can be killed, before it's extended".

[9:59:43 AM](#)

Mr. Hawkins perceived the MCAC Study as "part and parcel of that process", regardless of the fact that the Department of Administration staff would argue differently, "We know when we're getting our chain pulled. We know when we're facing hostility; we know when we're trying to be set up to fail. While that's not the policy of the Governor's Office, and that's not the policy of everybody in the two agencies that we deal with, it is the agenda of too many of the people that are in a position of influence over this Program."

Mr. Hawker stressed it is not "the nature" of ASCI to say such things about its customers; however, at this point, the Legislature should be aware of what has been occurring. It should be placed on the record that, were "these dirty tricks" to continue, ASCI would not be taking "it quietly and let it happen in the dark".

[10:01:04 AM](#)

Senator Bunde remarked that, had State property been destroyed, he would view it as "verging on a criminal act" rather than as petty sabotage. Further investigation in this regard should occur. The actions shared could be "a very disturbing trend or a highly unfortunate coincidence". Continuing, he shared that the Senate Labor & Commerce Committee had conducted an oversight meeting the previous day in regards to "materials that were essential to the Aetna Insurance/Blue Cross Insurance RFP had mysteriously disappeared and then reappeared later." Due to serious concerns, he has requested a Legislative Budget & Audit (LB&A) audit of the State's procurement process to be conducted. "I am very concerned."

Co-Chair Green acknowledged.

[10:02:15 AM](#)

Senator Olson asked for clarification as to whether State property had been destroyed or had simply been made inaccessible to ASCI.

Mr. Hawkins responded "both". Some of "the clerical tools" that would have been "helpful" to ASCI had been thrown away; other materials had been hidden.

In response to a question from Senator Olson, Mr. Hawkins stated that he was not in the position to determine whether the disposal of tools that were developed to support the procurement process and which would have assisted ASCI in its transition would meet the definition of destruction.

Co-Chair Wilken thanked Senator Bunde for his initiative to request an LB&A audit.

Co-Chair Wilken, referring to the information on page 6 about the other entities to whom ASCI provides services, asked Mr. Hawkins to describe how the services provided in the private sector could benefit the State. In other words, he was seeking additional information about ASCI's experience.

[10:04:27 AM](#)

Mr. Hawkins responded that the services ASCI provides to Exxon Mobil and BP include "websites and Webtools that we host for them in connection with their Sakhalin Island [Russia] developments. Those contracts ... reflect our efforts to begin to participate internationally in this new oil and gas province off of the east coast of Russia". These small projects include such things as hosting both entities' official bilingual project websites as well as technology relating to international vendor registrations.

[10:05:30 AM](#)

Mr. Hawkins, for business purposes, chose not to disclose the company's gross income. Continuing, he characterized the SOA Program as not being a huge piece of ASCI's business in that only eight of 160 employees are involved in the project.

Co-Chair Wilken asked whether "the lessons learned" from ASCI's private business practices are integrated into the State program.

Mr. Hawkins affirmed the lessons learned from ASCI's relationships with BP and the other private sector operations are integrated with PPP. This would include ASCI's ability to build functional Webtools cost effectively and the utilization of its measurement and process management tools.

[10:07:03 AM](#)

Senator Olson, noting ASCI was structured as a LLC (Limited Liability Corporation), asked regarding the owners of the business.

Mr. Hawkins responded that Alaskan individuals, including members of its management team, primarily own ASCI. Companies such as Frontier Plumbing in Fairbanks and Engineered Equipment, Alaska Pump and Supply, and Dowman Bock in Anchorage. Puget Sound Pipe and Supply are also owners.

Senator Olson asked regarding Mr. Hawkins' background experience.

[10:07:58 AM](#)

Mr. Hawkins communicated that previous to working with ASCI, he had been a private practice consultant in the field of supply chain management specializing in such things as inventory optimization and vendor performance management. Prior to that, he had been president of the Anchorage Economic Development Corporation. That organization's effort to market Anchorage as an international distribution center led to his interest in the supply chain management field.

Senator Olson noted the private industry customer base depicted on page 6 is comprised primarily of "oil industry related entities". Thus he assumed Mr. Hawkins' background must include oil industry experience.

Mr. Hawkins answered he had been "heavily involved" in supply chain management in the oil industry for the past ten years primarily because "that's where a lot of the action is" in this State. His business partner's background was in the supply and distribution industry. Other management team's backgrounds are varied.

[10:09:37 AM](#)

Senator Olson asked he be provided with a copy of the correspondence from the two SOA employees who directed ASCI to conduct their own study in order to discuss the MCAC report.

Mr. Jackson responded that one of these directives was communicated via an email and the other was through a telephone conversation. The email would be provided.

10:10:31 AM

Co-Chair Green asked whether the basis of the opposition has been identified.

Mr. Jackson was "sad to say that it's an all too often situation I observed during my career. I feel there's a certain amount of protection of empire involved here. A certain sort of heartfelt belief that purchasing for government can't be done by anybody but government employees, and that this is a silly idea, and cooperation just isn't going to be forthcoming." It could be "the heartfelt belief that it's wrong to do business this way" combined with "the idea that if procurement can be outsourced what's next".

Co-Chair Green asked whether the opposition came from management as well as "rank and file" employees.

Mr. Jackson communicated that in his capacity as an ASCI Smarttools trainer, he had the opportunity to work in a variety of State offices. He had a sense of the line employees' feelings about PPP verses the sense he gathered from "higher level management folks". The line level employees viewed it as just another thing they had to learn how to do, and, as training transpired, they accepted the change. He did not witness that "sense of coming around" in the management team.

Mr. Jackson shared that, prior to becoming an ASCI employee, he had conducted a management review on behalf of ASCI. During the first month PPP was implemented, the State's contract administrator at that time, Charlie Daringer (ph), who "was managing on behalf of the State ASCI's performance", told him "in a semi-confidential way in the sense that" they had previously worked together, "that he was adverse to this Program". He "did not see how it was ever going to save money, and he had prepared or worked on preparing some form of a document that was going to recommend that it not be continued." Mr. Jackson verbally requested a copy of that document. After failing to receive the document, he later made the request in writing. Mr. Daringer's [ph] response was that he was "not the custodian of records on this, if you want to get records, you're

going to have to request them" from the DOT Commissioner's Office. At this point, Mr. Jackson informed Scott Hawkins of the situation. Mr. Hawkins' decision was, considering this was occurring at the beginning of a new situation, "let's try to just work through this." Unfortunately the "attitude" experienced at the onset has "prevailed throughout this contract at the upper levels of management".

10:14:46 AM

Dr. OLIVER HEDGEPEETH, Professor, University of Alaska, testified via teleconference from an offnet site, and communicated to the Committee that, as part of its free community service program, the Logistics Department at the University performed an analysis of the MCAC Study findings for ASCI.

Senator Bunde understood a University Masters Class had conducted the analysis on to the Study.

Dr. Hedgepeth affirmed. The analysis was conducted by a graduate course he teaches which focuses on measurements of supply chain. He has 39 years of history as a mathematician. The class conducted an analysis of both the MCAC Study and an evaluation of the business process of ASCI's "cost of goods procurement process as a matter of course in developing a case study which we as a group are writing up to publish in a peer review journal on how business can be done in a private company from a State request".

10:16:12 AM

Senator Bunde inquired as to how the determination was made to focus on this particular case study.

Dr. Hedgepeth responded that "former students" who are now employed at ASCI communicated to him that ASCI was "a place that had good insight on supply chain management". Mr. Jackson and Mr. Hawkins asked him and his "team" whether they would like "to gather more information about the business process for use in our class". He characterized the logistics class he teaches as "dirty logistics" in that he likes "his students to get out in the field prior to graduation". Consequently the class considered "developing a case study based on some of the work that ASCI was doing". He asided that the class also conducts such studies for other companies in its endeavor to understand

the mechanics of doing business in the Alaska supply chain industry.

Senator Bunde queried as to whether an evaluation of "the effectiveness and the accuracy of the procedures" of each particular case study is conducted.

Dr. Hedgepeth affirmed, "that is investigated". He disclosed that he had not allowed his class to see the reports from Northern Economics and Altman Rogers & Co. until a few days ago. The effort was to "investigate and try to understand the business process from our standard view of how cost of goods and services should be measured in any situation. We try to develop a generic process. Now they've looked at these reports ... and it was interesting that our methodology seems to conform to statements by Northern Economics and Altman Rogers."

Senator Bunde understood therefore that the class deemed the Northern Economics and Altman Rogers studies to be a "more accurate portrayal of the facts", and that the MCAC Study could be characterized as "inaccurate".

Dr. Hedgepeth stated that in his terms, the MCAC Study would receive an "F" grade. The Altman Rogers & Company and Northern Economics, Inc reports on the MCAC Study would receive an "A" grade.

Senator Bunde acknowledged Dr. Hedgepeth's expertise in this field and concluded that the Study is flawed and that "the reports of the report seem to be a good portrayal".

[10:19:35 AM](#)

DON PETERSON, Senior Manager, Mikunda Cottrell Accounting & Consulting (MCAC), clarified for the record that there are two Mikunda Cottrell firms in Anchorage. MCAC is not associated with the Mikunda Cottrell auditing firm.

Mr. Peterson provided an oversight of the project MCAC was requested to perform as well as "what was not requested of us". MCAC compiled a Study titled "State of Alaska Division of General Services Cost of Goods Analysis" [copy on file] dated November 25, 2005 "which reviewed a number of items on the cost of service for the State of Alaska". He summarized some observations included in the Study. The purpose of the Study was

to gain an understanding of the process to place goods, and methods for ordering the delivery of goods. "When we started that process, there was an attempt on our part to obtain enough matches within the State and ASCI system to provide statistical information. It became very clear very quickly that that was not going to be possible, and there's been a lot of comments here that this is not a statistically valid sample. We agree with that. The State, ASCI, and us very early on became aware that that was not going to be possible. And the three parties simply said should we go forward and perform an analysis that we know is not statistically valid. The answer was yes, and we did."

In response to a question from Senator Bunde, Mr. Peterson explained that even though there were 40,000 item transactions, there were only approximately 167 exact matches in the systems. Therefore, MCAC "tested 100 percent of the available items to test".

Senator Bunde asked for further clarification as to whom MCAC notified about the limited sample count.

Mr. Peterson responded MCAC had notified the State "about what could be tested". The understanding is that the State then had a discussion with ASCI in this regard.

Senator Bunde asked whom MCAC worked with at the State level.

Mr. Peterson identified Vern Jones and Tom Mayer with the Division of General Services, Department of Administration as the State representatives.

Senator Bunde understood therefore that even though MCAC had communicated to the State that the Study would be statistically invalid, the State's response was to continue.

Mr. Peterson affirmed the response was "to proceed". The Study would only be "considered an indicator of information". MCAC was "asked to proceed with that understanding, and that's exactly what we did because those were the procedures that we were asked to do".

10:23:40 AM

Mr. Peterson continued that "based upon the report that we issued, ASCI, as they testified, hired Altman, Rogers & Co. and

Northern Economics Inc. to take a look at our information, and both those firms concluded the results were statistically invalid, and we agree. We knew that going in, and that was an agreed upon procedure for the testing we were supposed to do. Everybody understood that this would not be a statistically valid sample. But again, the only items that were available were the 167 items. Now Altman and Rogers brought up a number of other issues. And I would like to address those at this time."

[10:24:52 AM](#)

Senator Olson asked "the validity of the Study if it's statistically invalid".

Mr. Peterson stated the Study would serve as "an indicator, and nothing more". MCAC informed the State of this and were told to continue.

Co-Chair Green asked whether MCAC had a role in publishing the Study as a public document.

Mr. Peterson responded "no"; the Study was delivered to the State of Alaska.

Mr. Peterson read into the record his firm's response [copy on file] to the Altman Rogers & Company Report as follows.

[10:32:59 AM](#)

Response to Altman Rogers & Company Report.

Mikunda Cottrell Accounting & Consulting (MCAC) was engaged by the State of Alaska, Division of General Services to conduct an analysis of the cost of goods procured by the State's procurement agent, Alaska Supply Chain Integrators (ASCI) at the Southeast Region (SER) of the Department of Transportation and Public Facilities (DOT).

The purpose of this engagement was to document the percent increase or decrease of the cost of goods procured by ASCI, when compared to similar purchases made by former state procurement employees at the SER over three separate reporting periods.

A report was issued for the first reporting period dated November 25, 2005. ASCI engaged the services of Altman Rogers & Company, Certified Public Accountants to review our report. Altman Rogers & Company issued a report dated February 28, 2006, and MCAC has provided the following responses to that report.

IV. Clerical errors. We reviewed the unit price differences noted on the Altman report and find that the prices that were used on the Altman report were the prices on the delivery order (DO). The prices that were used in the MCAC report for ACSI were prices on the actual invoice paid. Our sample of selected comparable items was 167; of the 12 items noted on the Altman report, only two items were in fact errors, and they were clerical errors, and not critical errors. The results of our review are located in Exhibit IV. The two clerical errors resulted from an invoice that was not clearly legible and the other was from numbers that were transposed. The Altman report also referred to item number 115 as a critical error because our report does not include the item being comparable to an ASCI purchase. We researched this and determined that item number 115 is a comparable item; however, the Buyspeed DO numbers were transposed and have no effect on the results. We have determined that if we were to correct the two clerical errors on our original report, the percentage increase in cost would be 8.97%, instead of the 9.00% originally stated in our report. We have made these corrections in Exhibit A.

Date Discrepancies: From the selected samples of 167, we reviewed the list of 41 date differences noted in the Altman report and agree to one date difference. MCAC used the date of order from the Buyspeed program when selecting purchases in the reporting periods. We were unable to determine where Altman obtained the dates listed on their report. Copies of the delivery orders mentioned in the Altman Report are noted as Exhibit IVa. The date difference does not have any affect on the results of this report, because it is within the date range used for Report Number 1. We have made this change in Exhibit A.

V. Review of Adequacy of Transaction Research. Of the 167 comparable items in our report, we reviewed the 9 noted in the Altman report and found 4 where we would agree that the

comparable items were different. The results of this review may be seen in exhibit V.

We would agree that Line item 1, 7 and 16 are most likely not comparable. For item number 1, the ASCI description and the State description were the exact same, except the State's item said "diamond plate" and ASCI's did not.

Item number 7 is the same item name and description; however upon further investigation we noted that the item purchased by the State was purchased from Costco in a two package container instead of a one pack container like the ASCI purchase.

Item number 16 was for purchases of cellular telephones and two year cellular telephone service contracts. We would agree that these items would most likely not be comparable because the purchase by the State included additional items.

Items number 40, 44, 81, and 145 the State and ASCI DO's were the exact same description, therefore, we did not contact the vendors for additional information. Altman stated in their report that item number 44 was further researched and ASCI's order stated that the item ordered "must be balanced". We reviewed the Buyspeed DO and the actual invoice for ASCI and do not see anywhere on any of the documents that the item "must be balanced".

Item number 24, Altman stated in their report that ASCI ordered a T square and the State ordered a combination square. Review of the actual invoices for ASCI indicated that a combination square was in fact ordered by ASCI and the items are comparable.

We would agree that items number 1, 7 and 16 are most likely not comparable, and have been excluded from our sample. Item Number 121 is a comparing item, however the number was transposed. If you remove these items from our sample, and make the other clerical corrections noted in Section IV, the result would be an 11.57% cost increase instead of a 9% increase in our original report. We have made these corrections and recalculated our original Exhibit A. The results of these can be found in A-1.

Shipping: Shipping was not taken in consideration for the following reasons:

- Sometimes shipping was included on DO's where it said "shipping was included in price, and the DO was for more than one item. We could not determine how we could fairly assign shipping to the "part or item" in our sample.
- Shipping would be listed at the bottom of the Buyspeed DO as a separate charge. We could not determine how to fairly assign that cost if there was more than one item on the DO.
- Different quantities were ordered for each item, by the state or ASCI, since the quantities ordered were not identical, we are to assume that shipping costs (no matter how they are presented on the DO) must be different and we can not determine exactly how must to assign to each item.
- Additionally, we noted that the exact items may have been shipped to different locations (such as the ferry system) and would assume that shipping costs would most likely be different.
- Some DO's noted shipping as an estimate of .05 cents when it was obvious that it would cost more than .05 cents to ship an item.

Because of the above challenges dealing with shipping, we determined that we would leave shipping out, when possible as noted in our report.

Mr. Peterson interjected that shipping costs were not considered in the Study because there was "no uniform reasonable method to assign to it".

VI. Application of inflation factors. We noted that Northern Economics Inc. was asked to provide information on the application of inflation factors. We did not apply inflation factors because we, like Altman are not economists, and do not have the credentials to apply such factors. We did however, make note in our report that the passage of time should be noted when viewing the results of our procedures. In addition, the State provided information to us regarding the CPI [Consumer Price Index] and how it relates to items procured on State contracts and we listed that percentage in our report. We did not apply the

percentage because of the variety of items that were purchased. We did not that several of the vendors that we spoke to while we were conducting our procedures told us that the price of steel had increased during the reporting period and we noted that in our report.

The report by Altman also noted in this section that of the 167 matches, 82 were found to be beyond a 12 month period. The date parameters that were established for this engagement were very specific and exceeded a twelve month span. The reporting periods were the following:

Report Number 1: July 1, 2003 to June 30, 2004 compared with July 1, 2004 through June 30, 2005.

Report Number 2: July 1, 2005 to September 30, 2005 compared with July 1, 2004 through June 30, 2005.

Report Number 3: October 1, 2005 to December 31, 2005 compared with July 1, 2004 through June 30, 2005.

This section of the Altman report also mentions that comparisons that included purchases under supply contract and contained escalation clauses for inflation adjustments. The state advised us of the following:

1. ASCI must utilize all mandatory contracts.
2. ASCI must utilize non mandatory contracts to the extent practicable, but are not required to use non mandatory contracts.
3. It is not possible to tell based on the data at hand if the item purchased from the contract vendor was actually an item under contract as vendors, for example may sell many items that may not be on contract.
4. It is also not possible to tell if the purchases were actually made from a contract as the DO's do not refer to a specific state contract, therefore, the items may have been purchased from a vendor without regard to a state contract.

The state has advised us that less than half the purchases in the sample pool were from vendors with existing state contracts. In addition, only about one third of contract

vendor purchases were from contracts that contained a price adjustment clause.

VII. Weighting of transactions. We reviewed the information that was provided by Altman regarding the weighting of transactions. We clearly noted in our report that our methodology was to look at price increase or decrease per unit. The purpose of our report was not to determine cost savings for items that are not similar, as noted in the example regarding the paper clips and compressor. Additionally, ASCI and the State purchased in different quantities and accordingly, no uniform weighting system could be established.

VIII. Extrapolation to a Larger Population. The state provided us with the total value (\$11.1 million) of procurements conducted by ASCI for Report Number 1. The State advised us that while they do not dispute that services are included in the \$11.1 million reflected in Report One, the State or MCAC has not verified the cost of goods reflected in the Altman Rogers reports as \$6.8 million. In addition, we simply indicated in our Report Number 1 that if you were to take the cost percentage increase that was calculated using the data and multiplied it by the total amount of purchases conducted by ASCI, you would get that calculated increase in cost.

IX. Alaska Vendor Usage. We did not consider the percentage of usage by Alaska vendor's verses usage of vendors out of state. We would agree with the information in Altman Rogers report that the State monitors the percentage of vendor usage. The State provided us with reports that indicate ASCI utilized Alaska vendors on 62.77 % of purchases during the reporting period while the State percentage of use was 58.16% during the prior period.

Conclusion:

The methodology that we used to perform this engagement was agreed upon by the State and ASCI and was changed several times to accommodate the suggestions of both parties. Our report was for the procedures that we performed. We performed these procedures based on data that we received from the State, and in some cases supported by obtaining additional information from vendors and other

documentation. We have reviewed the items noted in the Altman report and believe the vast majority of the noted differences can not be substantiated. We believe there is an unknown impact from inflation and it was noted in our report. We also believe there are many alternative methods in which to present this data, but that would require more unknown assumptions. We believe our original report, as amended, is essentially correct according to our agreed upon procedures with the State of Alaska.

[NOTE: Copies of Exhibit IV, Exhibit A, Exhibit IVa, Exhibit V, Exhibit A-1 are on file.]

[10:38:52 AM](#)

Senator Bunde characterized the final sentence of the response as "very telling". Any criticisms of the Study or the "limited applications" in it should be mindful of the fact that the Study "did what it could do ... according to" MCAC's "agreed upon procedures with the State".

Mr. Peterson affirmed, "that's exactly what the report did. It's nothing more than an indicator of what we found".

Senator Bunde voiced that the limitations of the Study limit it.

Senator Bunde asked the cost of the Study.

Mr. Peterson recalled the cost being in the range of \$20,000 to \$30,000.

[10:40:17 AM](#)

Co-Chair Wilken asked whether Mr. Peterson would agree that the amount of correspondence between MCAC and the State would equate to approximately 1,040 pages of paperwork.

Mr. Peterson clarified that another of his co-workers was the primary person working on this endeavor. He could attest to the fact that "a significant amount" of correspondence had occurred.

Co-Chair Wilken asked whether Mr. Peterson would concur with language in the Conclusion section on page 13 of the Altman, Rogers & Co. Report titled "Alaska Supply Chain Integrators, LLC Mikunda Cottrell Accounting and Consulting Costs of Goods

and Services Report Management Review and Analysis" [copy on file] which reads as follows.

Based on these issues and other factors detailed in this report, the conclusions reported by MCAC are unsupported. In addition, due to numerous noted deficiencies in the data set and the methodology selected by MCAC, it is unreasonable to expect that the MCAC study could be corrected to provide reliable conclusions.

10:41:09 AM

Mr. Peterson responded that MCAC reviewed each of the issues raised in the Altman, Rogers & Co. report. MCAC has determined, as reflected in the MCAC written testimony Mr. Peterson had read into the record, "the vast majority of ... what they found was incorrect". Both the Altman Rogers & Co. and the Northern Economics studies addressed the statistical validity issue. MCAC would agree that the Report should not be considered "in any way shape or form" a statistically valid sample. "We don't pretend that it was." MCAC was told to "proceed and tell us what the answer is" even though there is a limited number of transactions. MCAC never represented the Study as statistically valid.

Co-Chair Green asked whether MCAC communicated that view as part of the document when it was transmitted.

Mr. Peterson replied that while that issue was not addressed in the Study's conclusions, it is very clear that it is not statistically valid. Only 167 items were matched.

Co-Chair Green asked the reason the lead person on the project was not in attendance.

Mr. Peterson pointed out that MCAC received short notice about the meeting. The primary individuals who worked on the project were outside the State.

10:43:02 AM

Senator Hoffman remarked that, while the Study might not be statistically sound, it would serve as an indicator.

Mr. Peterson stressed that the Study should be viewed as "an indicator of what we found". How the information is used is another issue.

Co-Chair Green referenced remarks in the Conclusion of Mr. Peterson's testimony as follows.

The methodology that we used to perform this engagement was agreed upon by the State and ASCI and was changed several times to accommodate the suggestions of both parties.

Co-Chair Green asked whether this information is documented.

Mr. Peterson deferred to the Department of Administration to respond. The Department of Administration demonstrated to MCAC that after MCAC raised the issue about the sample size that "they went to ASCI and that they had discussions with them". MCAC was not involved in those discussions.

Co-Chair Green suggested that the language she had referenced in the MCAC Conclusion be restructured.

Mr. Peterson stated that, "the procedures in the report are what they are. They're an indicator of what we found." Nothing more should be drawn from them.

[10:44:28 AM](#)

VERN JONES, Chief Procurement Officer, Division of General Services, Department of Administration, understood that "the sole purpose and intent of the bill" authorizing PPP was to produce cost savings. The RFP included "strong language" in this regard. An emphasis on cost savings is also depicted in the ASCI proposal and on the record of that bill. "Clearly the intent here is to reduce the cost of goods and services that the State purchases." DGS has conducted quarterly benchmark audits of this contract. One of the identified "weaknesses" of the DGS reports was the analysis of the cost of goods, and in fact, this Committee criticized DGS in that regard in the past. While the DGS analysis was not scientifically or statistically valid, they had endeavored to find appropriate matches, and the information supported the determination that ASCI activities were resulting "in a significant cost increase." Because the results were statistically invalid, DGS issued an RFP to hire an independent

third party to conduct an analysis. The "well known accounting firm" MCAC was hired to conduct and analysis the cost of goods.

Mr. Jones "strongly objected to Mr. Jackson's characterization of the State's handling of this contract. I object because it's not true. We did not try and influence the outcome in any way. We simply cooperated with them to get them information, to find what they could find."

Mr. Jones responded to an earlier question regarding the conversations about what to include in the audit. Those discussions included himself, Mr. Hawkins, Cheryl Frasca, Director, Office of Management and Budget, Office of the Governor, and others. The use of State contracts, which is now an issue objected to by ASCI, was one of the items discussed.

[10:47:36 AM](#)

Mr. Jones communicated the State instructed MCAC "not to include purchases by ASCI off of State contracts. ASCI asked us to include those at the audit, and we did." Continuing, he noted the State's savings and other data figures "do not match those" depicted in Mr. Hawkins' presentation. An executive summary of the quarterly benchmark information could be provided. "Our figures do not match what I saw here today."

Mr. Jones had read the Altman, Rogers & Co. report and did not recall it specifying that ASCI had reduced the cost of goods for the State.

[10:49:27 AM](#)

Co-Chair Wilken brought the conversation "back to the statistics issue. It's hard to measure anything if your yardstick changes its size every other day." This would also apply to the scope of the project DGS engaged in with MCAC. While it was agreed that the Study would be statistically invalid, the decision was made to proceed. "But, clearly something changed" from the time of the August 25th letter to Mr. Jackson from DGS and November" when the Study was finalized. He referred to two of the four aforementioned questions in that letter and read the following excerpts.

- As professionals in the field, MCAC will independently determine a statistically valid sample size.

Does the State know how MCAC will determine the constituents of the sample and maintain statistical validity?

- No, MCAC will determine the samples and create a statistically valid pools.

Co-Chair Wilken determined from Mr. Mayer's responses in the August 25, 2005 letter that "he clearly expected" that "the measurements would be statistically valid and reliable". To that point, Co-Chair Wilken asked, "What changed?" after that letter was written and the time the Study concluded.

Mr. Jones reiterated that the internal studies conducted by DGS were known to be statistically invalid, because the Division could not find appropriate sample sizes. Thus the Division issued an RFP for the development of a statistically valid report and contracted with MCAC, an outside Certified Public Accounting firm. They too "could not find" a sufficient sample size. The sample size found represents "100 percent match of every exact match". A lot of work had been done at that point, and the contract was not halted. "What we want here is an indication of what's happening under ASCI so we can assess their performance." Thus the determination was made to continue with the Study, as a lot of work had occurred up to that point.

Co-Chair Wilken stated that the response had not addressed his question. There became a point in time "when this Study became a waste of time and money because the yardstick was invalid". The question is when did that happen and who made the decision to proceed, knowing that the end result would be a study that could "not be relied upon, let alone" publicly published.

[10:53:59 AM](#)

Mr. Jones was unsure to the exact date of when the decision was made to continue.

Co-Chair Wilken asked whether Mr. Jones was involved in the decision.

Mr. Jones affirmed he was.

Co-Chair Wilken asked whether the decision might have been made in either September or October.

Mr. Jones could not recall.

Co-Chair Wilken asked whether the decision was made "early on in the process when you found that the yardstick was going to change" or whether it was made mid or late in the process.

Mr. Jones reaffirmed that he could not identify an "exact" timeframe. At some point, we had a conversation with ASCI and conceded to their request to include a number of other State contract items in the study "in an attempt" to enlarge the pool.

[10:54:53 AM](#)

Mr. Jones "objected" to the position that the Study was of no value. It did provide an indication of the activity.

Co-Chair Wilken disagreed. The Study is statistically invalid, whether it was the basis for ASCI to proclaim that their service had saved the State nine percent or whether DGS claimed otherwise. "You can't put this out as a work product if it's a dartboard. And that's what you've done." MCAC must have informed someone at some time "you are publishing something that is worthless". While it is "a nice review of the facts", it is worthless.

Co-Chair Wilken expressed appreciation for the fact that the problems PPP has experienced have been brought forward. "It's time that this become public...I'm so disappointed in why we're here talking about this Study that professionals, including you, should have stopped from ever being published."

Co-Chair Wilken asked whether Mr. Jones had been concerned that the consultant hired did not have the expertise to incorporate an inflation factor.

Mr. Jones countered that the firm was a reputable accounting firm "fully capable of analyzing data". While they are not statisticians they could conduct sample comparisons.

Co-Chair Wilken acknowledged; however found it "somewhat strange" that a firm without such expertise had conducted the

study. He appreciated the firm admitting, "that ... they don't have the credentials to apply inflation factors".

Mr. Jones pointed out that ASCI's contract firm, Altman, Rogers & Co. did not have that expertise either.

Co-Chair Wilken replied, "Altman Rogers didn't write this".

Co-Chair Green, voicing disappointment that the Study had been publicly published, asked how that decision had been made. While the immediate participants might understand that the findings were statistically invalid, the public could perceive things differently. "That's kind of below the belt."

Co-Chair Wilken noted that on various occasions, "we have ... had conclusions waiting for a study. This is another one."

AT EASE 10:58 AM / [10:59:21 AM](#)

ART CHANCE, Director, Division of Labor Relations, Department of Administration, informed the Committee that in his position he works with the three organized labor unions that represent "the employees who would be at issue in this matter of the 800 pound gorilla in this ... As confusing and conflicting as the various versions of the economic analysis might be, at some point", he would be required to "submit those confusing and conflicting versions of the economic realities to a labor arbitrator who's going to tell us whether or not we've violated these agreements." One arbitrator has already informed him that the process the State used "to initiate this, at least under the supervisory contract violated their agreement." While she had not halted the process, she had expressed that any effort to "expand or renew this process, we had to demonstrate feasibility by a means other than that which we used to initially demonstrate it ... The initial feasibility method was basically to take the contractor's proposal and compare it to our costs. We went out and asked that there be proposals to do this for us and we compared it to our known costs". The arbitrator "concluded that that did not satisfy the requirements in the labor agreements, all of which required demonstration of economic feasibility in order to lay off State employees and replace them with a private contractor."

Mr. Chance admitted not knowing "what a feasibility study would look like under these labor agreements that would satisfy any

third party tryer of fact. Our collective bargaining law absolutely militates against us outsourcing to the private sector any work being done by State employees. The labor agreements that control the employees that are subject to this, labor trades and crafts, general government and supervisory, all have 'contracting out' language that permit us to outsource where there is a demonstration of feasibility". However, "there is no definition of what a demonstration of feasibility is."

Mr. Chance reminded the Committee the State has, in the past, outsourced and sustained that action through arbitration. However, the State has also at times lost the arbitration of those activities. He could not discern "what the difference is between the ones where it was feasible and the ones where it was not."

Mr. Chance communicated "that probably the only way that we would change that 'contracting out' language in any of those agreements is after the strike. These are very valuable pieces of language to these unions." In this case, there are active grievances with all three labor unions. While the Division has collected as much data as possible in this process, he would be "facing third party neutrals in an if lawful binding decision, and they're going to be hearing the same thing that you are hearing today. The State saying it's feasible using one body of economic knowledge; the unions saying it's not feasible using another body of economic knowledge. That's the situation." He has "pressed for much of this measurement because" the situation must be addressed.

[11:03:50 AM](#)

Co-Chair Green inquired as to whether a statistically valid Study would have assisted Mr. Chance in this effort.

Mr. Chance was unsure as to whether "a cost of goods would be a part of the feasibility study. One party's going to argue that it should be and the other party's going to argue that it shouldn't. The State's position would be that we're going to maintain this process because the Legislatures told us to. We would have to say that feasibility is only a measure of what our labor and administrative costs are, costs of goods are not a part of that." The union position would be that while some labor costs might be reduced, "they're costing themselves a lot of

money on cost of goods". The arbitrator's position on this would be the unknown.

Co-Chair Green remarked "what a travesty".

Co-Chair Green identified labor management as being the root of the problem. This involves "lower level employees who would like to see this scuttled who would do anything they can to make it not happen and who would not want this to go forward".

Mr. Chance "would not go so far as to attribute individual actions to individual employees" ... as there is no evidence in that regard.

Co-Chair Green agreed, however, declared, "collectively, I would".

Mr. Chance stressed, "there are three organizations that have intense institutional opposition to us doing this or anything like it."

[11:05:53 AM](#)

MARK O'BRIEN, Chief Contracts Officer, Division of Contracting, Procurement and Appeals, Department of Transportation and Public Facilities indicated he had not been present earlier in the meeting because he had not anticipated his Department being part of today's discussion. However, after hearing his name mentioned he decided it best to join the discussion.

Mr. O'Brien stated that Mr. Hawkins' remark about his feelings being hurt when the Program was adopted "was not a fair characterization. What is a fair characterization is is that there was at that testimony and those hearings a discussion about the cost of goods savings, and the number \$20 million was thrown out." Mr. Hawkins indicated that that was "a conservative estimate". He, a 28-year veteran in the State's procurement system, viewed this as "a little insulting to think" that the years of efforts to enter into multi-agency contracts and to use our professional expertise to achieve the best savings possible for the State, that somehow we were missing the mark by a number that large." To imply that his "feelings were hurt, I would say it was frustrating and it was insulting to the profession of the folks that had been doing the job up to that point".

Mr. O'Brien professed having no bias at the onset of PPP. The Department of Transportation and Public Facilities commissioner asked him to assume "lead for the Department in interacting with the Department of Administration and ASCI in implementing this within the Department."

Mr. O'Brien addressed the issue of destroying State property by characterizing it as "a red herring". The activities being referred to "were the result of frustrated employees who were laid off as a result of the outsourcing."

Co-Chair Green interrupted to proclaim that any action of employees who were frustrated "because they got released is inexcusable".

Mr. O'Brien clarified that the material that was destroyed was not State property, "and it's excusable because what they were getting rid of were their own personal vendor lists and things they kept as part of their job." An example would be "your Rolodex on your own desk. In most cases, it was a process of cleaning out the office before ASCI came in." ..."One employee stated 'Well, I'm not going to help them anymore than I can' and he threw his Rolodex away into the trashcan."

Co-Chair Green stated that action is "inexcusable."

Mr. O'Brien stated it's frustrating.

Mr. O'Brien noted that when the Department became aware of the behavior that was occurring, it conducted "numerous meetings" and memorandums were issued. Department of Transportation and Public Facilities management "instructed employees to actively, voluntarily, and aggressively participate" with ASCI. He recalled a meeting of the Southeast Region of the Department, which was section to which the PPP would apply, which was held around July first, the approximate time ASCI was to assume procurement responsibilities.

[11:10:56 AM](#)

Mr. O'Brien continued that at that meeting, the Director of the Southeast Region, Gary Paxston, addressed the entirety of the southeast regional directors "and in no uncertain terms described to the employees the participation and their role in this Pilot. It was blunt, it was very clear..." Those employees

left "knowing what management's position was on their assistance in rolling the program out." It would be incorrect to say that the Department had not addressed employee behavior or had not assisted in the transition.

Co-Chair Green appreciated that information.

Co-Chair Green asked Mr. Hawkins whether he had concluding comments.

[11:11:42 AM](#)

Mr. Hawkins agreed with Mr. O'Brien that Gary Paxston had made "a good faith effort to shoot straight from the shoulder and help us where he could." He had provided "significant leadership" to the Department and was a "lifeline for us." Mr. Paxston has retired and has been replaced by someone new to the process.

Mr. Hawkins puzzled between "the distinction in feeling insulted and having one's feelings hurt."

Mr. Hawkins addressed the comments presented by MCAC. "Part of what we're seeing there is just an unfamiliarity with doing cost of goods research ... It's clear that they're struggling to evaluate the data. One of the first things that you do when you take a data set like this and when you're going cost of goods analysis, is you do outlier analysis. If you have 167 transactions, and you're doing what they were doing of adding them all up to a bottom line result, and tallying it and comparing it to the same column next to it, one or two or three transactions in that list can have a disproportionate affect on the bottom line result. That is why, everybody has agreed here this morning, and I have to tell you I'm pleasantly surprised and floored that everybody has agreed that this Study is statistically invalid. But that's why it's statistically invalid. Because when you use methodology like that, one or two transactions can skew the thing wildly." Thus someone familiar with this field would conduct an analysis and identify "suspicious" transactions. Identify the best ten or 15 and the ten or 15 "worst" transactions; "those that are disproportionally impacting the results and research those carefully and make sure that those are valid transactions. Because when you're looking at 50 percent or 70 percent changes in prices, there's an excellent chance that there's something

wrong there. It's freight, it's item comparability, it's this item has a service included and this item doesn't". The MCAC comment made in regards to the fact that "they could not tell on the comparability question" whether this item required balancing or shipping and "this item didn't" is indicative of their unfamiliarity with the process. "You have to follow up and call the vendors, you have to drill into those transactions and ask the question of why are these so different. And then you'll get to the bottom line answer. And nine times out of ten what you'll find is the item for one reason or another that's not a 50 percent or 70 percent or even a 25 percent difference. Usually it's not a fair presentation. Prices don't vary that much." ASCI took the top ten and the worse ten and conducted that research; they "called the vendors and followed up", and "we determined that seven of the ten in both cases, top and bottom, were invalid." Altman, Rogers & Co. conducted significantly more comparability research.

Mr. Hawkins concluded that MCAC was simply unfamiliar with the required work, and was unable, from a procurement standpoint, to distinguish what the differences were.

Mr. Hawkins did not believe there was malice on the part of MCAC. There was just "unfamiliarity and perhaps a failure to recognize when the credentials aren't there and maybe they're participating in something that's going to have a very bad impact on both a local company and State policy."

Co-Chair Green, in consideration of an impending Senate Floor Session, stated that the presentation must conclude. She appreciated the information. Committee members should inform her of any further desired action.

Senator Bunde determined the Program to be working, and in that regard, asked that consideration be given to expanding it.

Co-Chair Green agreed.

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ADJOURNMENT

Co-Chair Lyda Green adjourned the meeting at [11:17:39 AM](#)