

PRIVATIZATION  
Reports/Papers

Selection of Documents:

Kansas  
Illinois  
Pennsylvania  
California  
Miscellaneous

3/96



# EXECUTIVE SUMMARY

The Kansas Council on Privatization was created by the 1994 Kansas Legislature (S.C.R. 1626). The 15-member Council, chaired by Jeffrey A. Chanay, was asked to study the issues surrounding contracting for private performance of governmental services, identify state services that may be in competition with the private sector, and develop recommendations that will make state government more competitive and improve the delivery of services to Kansas citizens. This report provides a detailed analysis of the issues surrounding this topic, with special emphasis on cost accounting, procurement, and the role of public employees. It contains over 30 recommendations to improve state government that are made to the Governor and Legislature of Kansas.

## **Need For A Privatization Framework**

The Council has concluded that despite the extensive use and long experience with various forms of privatization, Kansas state government lacks an overall framework for privatization decisions. There is a compelling need for a rigorous methodology and process for determining whether privatization options are appropriate, efficient, and effective.

## **Kansas Experience With Contracting Out**

Many agencies of Kansas state government have contracted with the private sector extensively to provide services in accordance with their respective goals and missions. As is discussed in Chapter Two, the Division of Purchases within the Kansas Department of Administration administers over 1,757 contracts for agencies throughout the state. The Council surveyed state agencies to gain information on their experiences with privatization and to obtain suggestions for improving the contractual process. Responses from 74 agencies

demonstrate that they have a sophisticated understanding of contracting out, and overall, have had a positive experience with contractual arrangements. The experience in Kansas, as well as that of other states, has shown that privatization alternatives must be considered carefully and the advantages and disadvantages of this approach should be made explicit. A privatization checklist, or set of criteria, can be developed to identify the significant issues that must be considered prior to making a determination as to the appropriateness of contracting out for a given service or services.

## **Other States' Experience**

State governments have had extensive experience with contracting out to the private sector. Chapter Three of the report examines the approaches used in Texas, Michigan, Illinois, Massachusetts, and Colorado. The Council has relied heavily on the approaches and methods adopted in Michigan, particularly the analytical method which has been applied successfully, called the PERM (Privatize, Retain, Eliminate or Modify) analysis. Based on the review of other states, privatization efforts should: 1) define the problem; 2) emphasize competition; 3) identify goals and measurable results of services; 4) integrate privatization review procedures with the budget process; 5) ensure the accuracy of methodologies for comparing costs of public and private services; 6) ensure that contracting governments have sufficient capacity and adequate resources to monitor projects; and 7) recognize the importance of educating the public.

## **Cost Accounting**

Cost Accounting is the subject matter of Chapter Four. The decision to contract out or seek some other alternative to government delivery of pub-

lic services has to be made with full and accurate understanding of cost accounting. How much does it really cost for state government to perform a given function? How much would it cost the state to have one of its functions performed instead by a private sector business? Cost accounting systems are developed for the public sector, but have not been used to fully and accurately account for all indirect costs. Kansas state agencies perform that degree of cost accounting which is sophisticated enough to prepare the annual state budget. Kansas uses a computerized accounting system referred to as STARS (Statewide Accounting and Reporting System). State agencies are required by the federal government to adopt standardized principles for cost accounting. Office of Management and Budget Circular 87 requires state agencies to develop cost allocation plans.

Accurate comparisons of the delivery of services between the public and private sector depend on identifying fully allocated cost, which is the sum of direct costs, plus overhead or indirect costs. Estimating savings from contracting out also requires the estimation of avoidable costs -- those that will not be incurred -- and unavoidable costs -- those that cannot be eliminated. It is also important to understand the costs of contracting out, including contract administration costs, one time conversion costs, and potential reconversion costs.

Kansas state government now has adequate capability to perform the cost accounting necessary for fair and reliable analyses. The current system is sufficient to undertake a case-by-case investigation of selected services to determine if privatization or other efficiency-enhancing ideas should be adopted.

### **Procurement**

Procurement policies and practices are outlined in Chapter Five. Currently, state procurement is based on a competitive bid process, with few exceptions. While the state relies on the concept of "lowest responsible bidder," it has considerable

latitude to ensure that issues of quality, fitness, capacity, and responsiveness are met. The state has also adopted an effective process of relying on "procurement negotiating committees" (PNC) of state officials to contract for certain services (K.S.A. 75-37,102). The Council recommends more extensive use of the PNC approach. The Council finds a need to place greater emphasis on qualitative or value-based decisions in the contractual process.

The Council has articulated the following principles to guide future procurement: 1) long-term savings and system improvements should be favored over short-term savings; 2) private sector supply of goods and services should be preferred when there is no significant savings from public sector supply; 3) changes to the procurement system should encourage competition for state contracts; 4) the procurement system should be designed to provide accountability for procurement decisions; and 5) proper safeguards should be placed within the system to ensure vendor accountability. The Council has recommended statutory changes to strengthen the state's ability to deal with vendors.

The Council takes the position that the procurement system should remain as flexible as possible. However, the system should be designed to account for the cost of public provision of goods and services and the long-term value of goods and services provided by the private sector. At all times, the goal of the procurement system should be to obtain the highest quality product at the lowest cost with a fully accountable decision.

### **Public Employees**

The question arises in Chapter Six as to how to address the needs of public employees who will be affected by privatization decisions. The Council acknowledges that decisions resulting from a cost analysis that leads to contracting out or privatization of a state service can affect public employees. It also recognizes the importance

tribution that state employees make to ensure the effective delivery of public services, as well as the personal commitment they have to their careers and to serving the public.

Chapter Six outlines the operating assumptions of the Council, summarizes the existing rules and regulations governing layoff procedures, identifies the strengths and weaknesses of the existing layoff procedures, and outlines a series of proposals for legislative and gubernatorial consideration. These proposals include: 1) avoiding employee displacements by first relying on attrition and retirements; 2) making creative use of reassignments and transfers; 3) modifying the existing bumping procedures; and 4) adopting job sharing or reorganization alternatives that borrow from private sector experience.

The Council has recommended a series of proposals to provide assistance to state agency employees facing termination as result of privatization or other changes. These include: 1) providing skill-based training to enable a displaced employee to enter a vacant position; 2) allowing re-employment if a contract is terminated; 3) examining the treatment of benefits provided terminated employees; and 4) providing out-placement assistance, retraining, counseling, and assistance for entrepreneurial activity. The Council also suggests that the existing employee award program be modified to provide state employees greater incentive to suggest program improvements. A substantial percentage of the cost savings achieved from private sector service delivery resulting from a PERM analysis should be awarded to the state employee who directly suggested the adopted alternative.

### Candidates for PERM Analysis

The Council has identified in Chapter Seven ten specific services provided by state government that might provide an initial agenda for the analysis of privatization and contracting out. Some of those services are already delivered on a contractual

basis, but should be examined to determine if the current arrangements are effective and efficient, and if an acceptable quality of services being provided. The ten suggested services for PERM analysis are: 1) grain inspection, 2) state printing services, 3) travel information centers, 4) tourism marketing and development, 5) maintenance of highway rest areas, 6) state travel arrangements, 7) state motor vehicle ownership, 8) child support debt collection, 9) motor vehicle maintenance, and 10) security services.

### A System For Ongoing Analysis

A method for ensuring an ongoing procedure for analyzing privatization and other alternatives is described in Chapter Eight. The primary recommendation of the Council is legislative creation of the "Kansas Performance Review Board" (KPRB) to be responsible for managing and overseeing the formal decision-making process surrounding the privatization, elimination, retention, or modification of state government services and functions.

The KPRB would consist of five members appointed by the Governor and confirmed by the Kansas Senate. The Secretary of Administration would serve as an ex-officio, non-voting member of the Board. No more than three members of the Board would be from the same political party. Board members would be appointed to serve four-year staggered terms with at least two members selected to serve initial terms of two years. The members of the Board would receive compensation and reimbursement for travel and per diem.

The Board would receive an annual appropriation to fund the salaries and wages of a small staff and the operating expenses and other expenditures of the agency, as determined by the Legislature. The annual appropriation would also include funds to support the conduct of PERM analyses. The amount of state investment which the Council recommends for PERM-related activities is \$500,000

annually. This amount would be appropriated to KPRB alone, with KPRB being responsible for its disbursement for the KPRB staff, reimbursement to state agencies assisting or complying with PERM projects, and the payment of any private sector contractors that KPRB deems appropriate in given situations. Funding of \$500,000 would represent the actual total cost of the PERM program each year. However, depending upon KPRB's degree of success in achieving government cost savings and efficiency gains, a higher level of funding may be warranted in outlying years in order to pursue additional PERM projects or projects of a larger scope.

The Council has proposed a detailed process for the management and conduct of a system of analysis that closely follows the successful PERM analytical model adopted by Michigan. This process identifies the role to be played by the KPRB, the Secretary of Administration, and state agencies. It provides opportunities for public participation through open hearings conducted by the KPRB, and it allows informed decision-making by the Governor and oversight by the Legislature.

The Council intends for the KPRB to represent a compromise of interests between the executive branch, the legislative branch, the judicial branch, and the citizens of Kansas. The KPRB would draw upon a flexible blend of the talents of the Kansas Department of Administration, the Legislative Division of Post Audit, state departments and agencies, and private sector specialists. Most important, KPRB would be a new and impartial entity that would operate from a solid, analytical foundation.

## Chapter Two

### CONTRACTING OUT IN KANSAS STATE GOVERNMENT

The Division of Purchases within the Kansas Department of Administration administers over 1,757 contracts for agencies throughout the state. These contracts are written legal agreements between the state and various vendors to provide goods and/or services to the state. Some of the contracts are for one or more agencies, and some are statewide (for all agencies). Many of the contracts are awarded to one vendor and some to many vendors. They are for a wide-range of goods and/or services, such as aggregate, food, vehicles, typewriters, computers, etc. Many of the contracts are for goods and/or services that could have been provided by the state, but instead were awarded to the private sector. Examples are leases of agricultural land to local farmers, air charter services, travel services, alcohol and drug abuse services, barber services, collection services, janitorial services, laundry services, pest control services, mailing services, programming services, refuse collection, security guard services, snow removal services.<sup>1</sup>

In order to gain a better appreciation and understanding of the extent that contracting out is utilized by state agencies and of agency experience with contractual services, the Council mailed an open-ended survey to the heads of 99 state agencies. The survey contained eight questions asking for a description of the extent of contracting, the type of services contracted, the problems experienced by agencies, and suggestions regarding contracting. (See Appendix 1 for a copy of the questionnaire.) Seventy-four agency responses were received. (See Appendix 2.) The results of the survey are covered in this chapter. Many of the agencies provided very insightful comments in response to the questions. The survey demonstrates that, generally, there is a very sophisticated understanding among the agency heads of the value of contracting out, as well as the difficulties involved.

A list of current contracts provided to the Council by the Division of Purchases and the responses to the Council's survey indicate that most goods and services now provided by government can be obtained from the private sector. The Division of Purchases' list of contracts ranges from accounting services to X-ray maintenance. The variety of contractual services is tremendously diverse. Appendix 3 lists the goods and services that are currently contracted out by most of the Kansas state agencies.

Most state agencies contract out for services. In some cases, almost half of an agency's budget can be devoted to contractual services, for example:

State Agency	Percent of Budget Contractual Services
Kansas Dental Board	57%
Citizens Utility Ratepayer Board	41%
Kansas Development Finance Authority	50+%
Kansas Public Employees Retirement System	84%
Kansas Wheat Commission	55%
State Board of Indigents' Defense Services	56%
Department of Social & Rehabilitation Services	65%

State agencies contract for goods and services for a variety of common-sense reasons, such as:

<sup>1</sup>This information was obtained from Jack Shipman, Director, Division of Purchases.

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- Inability to justify in-house staffing for specialized expertise or technical skills.
- Lack of civil service positions available to the agency.
- Need to provide faster, more accessible services to clients or increase convenience for clients.
- Need to stabilize workloads and the number of employees during high and low volume seasons.
- Decision or preference of an agency's board of directors or chief executive officer.
- Skills or expertise not available in the public sector.
- Magnitude of agency workload.
- Cost-saving measure. Competitive bidding generally reduces costs.
- State salaries are not competitive to recruit and retain qualified staff.
- Need to complement skills and expertise of existing staff.
- Need to free agency staff of mundane or routine, time consuming duties and utilize staff for higher-level responsibilities.
- Need for short-term or part-time staffing.
- Greater responsiveness of the private sector to changing demands and requirements.

In summary, the lack of in-house skills or expertise, the inability to add state employees to the agency, and the ability to achieve cost-savings are the most frequently mentioned reasons cited by agencies for contracting out.

### Problems Experienced by State Agencies With Contracting Out

The Council's survey of state agencies asked "What problems have you identified as a result of contracting for services?" The typical response was "none," "few," or "no major problems." Generally, Kansas agencies expressed considerable satisfaction with their current experiences with contractual services.

Among the problems or areas of dissatisfaction that were stated are the following:

- Higher costs than anticipated, especially among legal contracts or other specialized professional services.
- Services available only from sole source providers, especially in rural areas.
- "It is occasionally difficult to find bidders qualified vendors."
- "Not always do we receive quality service on a timely basis."
- Failure of contractor to understand the duties expected.
- "The lowest bidder is not qualified to perform for such a demanding short period of time."
- Selection of an untried vendor because of lowest bid.
- Difficulty in switching back to in-house services if contractor is not cost-effective.
- "Effectively monitoring private provider performance can be challenging."
- Contracting process is arduous and time consuming.



The Department of Corrections and the Department of Social and Rehabilitation Services provided detailed responses to the question of "problems encountered." Their responses are quoted below:

#### Department of Corrections

The transition from one service provider to another can be disruptive to prison operations. Some contractors resent being required to compete for the contract and try to use various influences to gain an outcome favorable to them. On rare occasions the contract relationship can become adversarial rather than a partnership. In isolated instances, the Department has been dissatisfied with the level of contractor performance and has terminated the contract. In capital improvement projects, typical problems might include delays in project completion, deviation from specification requirements, and overall quality control. These problems are minimized through careful bidder selection and close project monitoring.

#### Department of Social and Rehabilitation Services

1. Many social services are complex and difficult to establish standards and criteria for monitoring. Client services tend to be more subjective on desired outcome, difficult to measure, and open to liability issues.
2. Expertise is different and varies depending upon whether the Department is purchasing a generic service from a market in which the Department is the sole purchaser of that service.
3. Since the Department tends to be the sole purchaser of many types of client services, the value and cost-savings attributed to contracting or granting, due to market economy and competition, does not exist. In addition: when there are an inadequate number of providers, the Department often has to develop

and support the market; the Department has to assume greater responsibility and expense for the training and retraining of community providers whose sole market is the Department; 'cream-ing' always has the potential to surface as a problem where there are an inadequate number of providers or few providers.

4. Increased administrative effort is required. Oversight and monitoring are essential but often not possible due to staffing patterns.
5. Evaluation and monitoring functions, supported by adequate data systems, become essential in order to ensure services are delivered, and delivered in an acceptable manner. Grants and contracts to community providers take considerable staff time to ensure that providers comply with all requirements, serve only eligible clients, and provide quality service.
6. In privatizing client services, costs-savings must not be the only criteria. Client access to services, flexibility in meeting client needs and the need for special expertise must be considered.
7. In any cost comparison analysis, cost-savings need to be computed over several years as what appears to be an initial savings often becomes a cost increase in out years. Also, in order to get a bid, contractors may bid 'low' and then increase their costs in following years.
8. The inability to guarantee numbers of participants often makes the bidding process time consuming.
9. Bids have come in at a price that is far higher with less service than prior arrangements.
10. Quality of staff hired by grantees or contractors can be problematic. In situations where

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contractors pay low wages, frequent turnover has occurred in staff, affecting quality and performance of services.

11. A potential problem, especially with major data systems, is the propensity to become so dependent on the expertise and knowledge of the contractor(s) that Department staff find themselves totally dependent upon the contractor; because of a lack of personnel to monitor the contract, performance and accountability are not closely monitored.

12. The Department finds that there are mixed expectations on the part of the community at large as to degree of control and oversight that should be given by the Department. Expectations must be made clear.

### A Privatization Checklist

Kansas state government agencies have extensive experience with contractual services, and most agency officials have a very sophisticated understanding of the advantages and disadvantages of privatization. It is evident that contractual arrangements with the private sector are not automatically superior to direct provision by government. The decision to privatize or contract out needs to be weighed very carefully and analytically.

A few states have developed checklists for judging the pros and cons of contracting out. Such checklists often stipulate a number of questions that must be answered or criteria that must be evaluated before the decision can be made. Colorado, for example, has prepared a *Privatization Assessment Workbook* (Colorado State Auditor's Office, 1989). The Colorado workbook identifies nine issues that should be assessed in the privatization decision. These are excerpted as follows:

1. Market Strength: the commercial characteristics of the service.

Issues:

Is the private sector able and interested in delivering the service?

Does (or can) the private sector provide the service?

Are there multiple providers?

Would privatization result in a monopoly situation?

2. Political Resistance: the amount of opposition to change in who provides the service.

Issues:

Is there strong support for government provision?

Is the service a new or existing one?

3. Cost Efficiency: the expected cost of the service, assuming no change in the level or quality of service.

Issues:

Will costs decrease or increase? Will the cost of services to clients decrease or increase?

4. Quality of Service: the expected impact on the effectiveness, timeliness, thoroughness, etc. of the service provided.

Issues:

Does privatization threaten preservation of client confidentiality, or impartiality toward clients?

Are certain targeted groups likely to be neglected?

Will accountability and responsiveness to the legislative branch, government agency, or consumer increase or decrease?

5. Impact on Employees: the effect on government employees.

Issues:

Will public employees lose their jobs?

Will public employees be hired by the private firm awarded the contract?

How many employees are affected?

6. Legal Barriers: the effect on any laws.

Issues:

Are there any laws that mandate who will deliver the service?

Do laws have to be changed to allow the private sector to provide the service?

Are there federal grant restrictions that interfere with privatization?

Is privatization compatible with legislative intent?

7. Risk: the degree to which government exposure to hazards increases.

Issues:

What chance is there that the private firm may fail to provide the service?

What are the consequences if service is interrupted or stopped? Would public safety be threatened?

Does the financial risk from lawsuits increase or decrease?

Does the risk of corruption or abuse increase?

Is government or the private sector responsible for cost overruns?

8. Resources: the efficient and effective use of existing government assets.

Issues:

Does the private sector have expertise that is difficult to develop or maintain in a government agency?

Does the private sector have needed equipment or facilities not available to government?

Can the private sector react more quickly to the needs of customers?

9. Control: the government's ability to oversee the provision of the service.

Issues:

How important is it for the agency to control the delivery of services?

Can the agency adequately oversee the private contractor?

Can the agency write and manage contracts?

Is the quantity and quality of the service easy to measure and control?

This final criterion of "control" is deemed especially important by the Kansas state agencies that responded to the survey. As a general rule, services that are highly complex, vague in their objectives, or that lack specific performance measures may not be good candidates for privatization. If the performance of a service is difficult to measure, it is difficult to monitor the performance of the contractor and determine whether the terms of the contract are actually being fulfilled.

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# Chapter Three

## OTHER STATES' EXPERIENCE WITH PRIVATIZATION

Various states have adopted some type of formal procedure for formulating and implementing policies to promote greater competition among service providers.

### Texas

Statutory Provisions. In 1993, the Texas Legislature enacted H.B. 2626, which established the State Council on Competitive Government. The Council consists of six members or their designees, including the Governor, the Lieutenant Governor, the Comptroller, the Speaker of the House of Representatives, the presiding officer of the General Services Commission, and the Commissioner of the Texas Employment Commission representing labor. The Council is located in the Comptroller's Office. There is no separate appropriation for Council operations or staff but six people are assigned within the Comptroller's Office to execute the Council's statutory mission.

The Council is directed to identify commercially available services performed by state agencies. If the Council determines that those services may be better provided through competition with private commercial sources or other state agency service providers, a state agency has to engage in a competitive process determined by the Council.

In complying with this directive, the Council is statutorily authorized to adopt rules and regulations, hold public hearings, conduct studies, consult with private commercial sources, require state agencies to conduct a study or a cost analysis of an identified state service, and require that an identified state service be subject to competitive bid. The Council is also authorized to develop the methods state agencies should use for cost analy-

ses and to prescribe, in consultation with affected state agencies, the specifications for and conditions of purchase procedures to be followed in providing the identified state service. Finally, the Council is authorized to award a contract to a public or private sector provider based on the best and most reasonable bid, which is not necessarily the lowest bid, and to determine the terms and conditions of such contract.

With respect to cost comparisons, the Texas legislation requires that the Council consider the cost of supervising the work of any private contract and the total cost, including indirect costs, of an agency performing a service. All bids and contracts are statutorily required to include an analysis of health care benefits, retirement, and workers' compensation insurance for employees of the contractor which are reasonably comparable to those of the state. The Council adopted a cost methodology on November 1, 1993, and revised it (draft version) in June 1994.

Another charge to the Council was the completion of a study by December 1, 1993, or soon thereafter (discussed below) to evaluate services performed by or for state agencies involving information technology, information facilities management, co-location of field offices, mail, print services, travel management, telecommunications, and fleet management. The intent of that evaluation was to identify at least \$3 million in cost savings and enhanced revenues resulting from competition with the private sector or other state agency service providers and transmit that information to the Legislative Budget Board. For its part, the Board would recommend reductions based on the Council's findings and the Comptroller would reduce appropriations to the affected state agencies in amounts approved by the Board.

Administrative Rules. The administrative rules adopted by the Council specify: the number of meetings; the procedures for developing Council meeting agendas, maintaining records of meetings, eliciting public comment, holding public hearings, and submitting suggestions for services to be considered; information required for submittal by agencies concerning selected state services; and procedures for determining whether or not to designate a service as a potential candidate for competition. If the Council deems a service to be a potential candidate, the adopted rules govern the appropriate means of ensuring competition among providers of such service; the required contents of all bid proposals; the factors to be used by the Council in evaluating proposals; protest procedures for parties aggrieved in connection with contract awards; minimum guidelines to be followed by the Council in monitoring contract compliance and performance; and provisions for assisting historically underutilized businesses in obtaining contracts (targeted to businesses owned by African Americans, Hispanic Americans, women, Asian Americans, and Native Americans).

Council's Study. The Council reviewed five issues: printing services, information technology, outgoing mail, prevailing wage, and telecommunications; analyzed the delivery of those services; and made recommendations on each.

In contrast to Kansas, Texas has a decentralized printing operation; 33 state agencies reported in-house print shops in Travis County (the location of the State Capitol). The Council conducted a survey and identified certain inefficiencies stemming from this operation. Recommendations included requiring the state print shops to be consolidated or state agencies to use private vendors.

The Council examined certain functions of the Department of Information Services, including its data center, existing applications support and maintenance, new applications development, and personal computer and local-area network support. It was recommended that data center operations,

the Department's applications development, and personal computer and local-area network support services be subject to a competitive bid process.

A survey was prepared and distributed to over 200 state agencies with the intent of collecting data to identify opportunities to reduce postage expenses through the increased use of presorting.

The Council surveyed 25 state agencies and university systems having some form of construction authority to identify methodologies used for determining wage rates. Based on survey responses, the Council concluded that the state does not adhere to a standard methodology for making such determinations. Responses were classified under three categories: agencies that have not made any prevailing wage rate determinations within the past three years and would not be engaged in construction projects any time soon (four agencies); agencies that use data that others have compiled (18 agencies); and agencies that routinely determine their own prevailing wage rates (three agencies). The Council recommended that the General Services Commission (comparable in function to the Kansas Department of Administration) consolidate wage rate determinations for state building construction projects.

The Council evaluated the TEX-AN system -- a state leased, private long distance telecommunications network providing lower cost-per-minute service for state government than is normally available in the market. The contract was scheduled to expire on August 31, 1993, and a new contract was renegotiated that was expected to yield 25 percent lower prices as a result of renewed competitive bidding. The Council recommended that the Legislative Budget Board reduce general revenue appropriations to state agencies and universities to recover at least \$5 million in identified savings on TEX-AN telecommunications services.

Recommendations for the Kansas Council. A telephone conversation with Michael L. Terrazas, Texas Performance Review staff, advised that

Kansas move slowly with its privatization efforts; that the cost methodology be carefully developed to be used for comparing the total cost of in-house service delivery with contracted service delivery; that initial privatization efforts address noncore services (not prisons or education); and that the state emphasize competition and look for considerable activity in the private sector for identification of possible candidates for privatization.

### Michigan

The process of making determinations with respect to privatization and other outcomes has been implemented entirely in the executive branch. There has been little legislative involvement with this activity. Two reports are summarized below concerning the analysis needed to improve government efficiency.

Final Report of Michigan Public-Private Partnership Commission. The Michigan Public-Private Partnership Commission was established by an Executive Order of Governor Engler dated July 30, 1992. The Executive Order directed the Commission to review a draft report on public-private partnership in Michigan and make recommendations to the Governor regarding that report within 75 days. An extension was authorized and the final report was issued in December 1992. The title of the report -- PERM: Privatize, Eliminate, Retain, or Modify -- signifies the four possible outcomes that might result from a comprehensive review of state government activities and programs.

Criteria for Privatization Decisions. The report identified 15 criteria for making privatization determinations:

1. ability to specify the requirements of the service in advance of production;
2. ability to switch from one producer to another without serious disruption in service delivery;
3. achievement of tangible benefits, such as operating or capital cost savings, higher quality

services, providing services not otherwise available, risk sharing, shorter implementation time, and solving political problems;

4. accountability in terms of process or outcome;
5. amount of efficiency gain;
6. availability or potential availability of competitive private sector producers;
7. characteristics of the activity (those concerning policy management, regulation, objectives related to equity, discrimination, stability of services, and social cohesion);
8. continuing need (if a program is not needed, it should be eliminated);
9. control of program or activity (necessary participation of the universities, State Board of Education, and the Legislature);
10. costs of resuming government production if privatization or elimination options do not materialize as planned;
11. independence between the nature of the final product and the methods used in its production (if "hands-on" control of the production process is necessary, privatization may not be a viable alternative);
12. legal constraints that may impede privatization efforts;
13. the determination of the level and quality of services needed;
14. monitoring costs of government agencies if privatization is the selected option; and
15. transition costs associated with shifting public sector service delivery to private sector service delivery.

Analysis Process. The report stresses the importance of determining the true cost to government in providing services when decisions are to be made on the disposition of such services. The report notes that an accurate analysis must include not only direct costs, such as salaries and wages, fringe benefits and travel, but also indirect costs, such as space rental, departmental overhead, interdepartmental costs, and indirect insurance costs. Internal operation costs must be identified in order to compare them to the costs of a nonretention option. Other costs must be considered as well: monitoring and regulatory oversight; making the transition from public sector to private sector service delivery; and resuming government production.

The report recommends that the actual analysis of programs or activities to make a determination of the appropriate disposition involve three parts: 1) identification of a program or activity and its history; 2) consideration of the effects or implications of privatizing, eliminating, or retaining or modifying a program or activity; and 3) completion of a cost analysis.

Report Recommendations. The report recommends that:

1. a PERM-type analysis be adopted using the criteria outlined in the report;
2. agencies be encouraged to diligently review their programs and activities, beginning with pilot projects identified in the report;
3. creative mechanisms be employed for current state employees to participate in the bidding process for contracts, in the outright purchase of state operations, or the right of first refusal of positions with private entities;
4. creative mechanisms be employed to ensure that all segments of the Michigan citizenry be afforded the opportunity to participate in contractual or purchase opportunities;

5. priority be given to Michigan individuals and firms to provide privatized state services or products and to ensure that Michigan residents are provided employment opportunities;
6. recommendations contained in an earlier report be fully implemented related to contract monitoring; and
7. all branches of government undertake the three-part PERM analysis.

Final Report on the State Purchasing System. In August 1993, Governor Engler appointed the Purchasing Reform Task Force to examine the state's purchasing operations and recommend improvements. This Task Force focused primarily on commodity and service purchases made by the Office of Purchasing in the Department of Management and Budget, as well as those made by other state agencies by delegation from the Office of Purchasing. The Task Force examined the existing state purchasing system and compared it with other purchasing systems. The intent was to develop recommendations designed to improve the efficiency and effectiveness of the state's purchasing activities.

The report described the purchasing system in Michigan as being comprised of 18 primary departments and numerous autonomous agencies; in 1993 there were more than 160 state employees in 86 locations throughout the state with authority to procure goods and services. The Office of Purchasing in the Department of Management and Budget (DMB) with a staff of 38 people is statutorily authorized to conduct the purchasing process. However, agencies have delegated authority to purchase designated commodities of up to \$2,500 and services of up to \$5,000 or \$10,000, depending on the service. State agencies break-up purchases into smaller units to assure that they stay within their delegated limits. Agencies also have unlimited delegated authority to procure medical or human resources. Agencies other than DMB have purchasing authority (transportation



infrastructure and building construction). Staffing expertise and training vary among the purchasing agencies. There also are no official promulgated rules and regulations implementing statutory purchasing provisions.

The report notes that the decentralized purchasing system results in numerous problems: duplication of commodities or services purchased; inefficiency stemming from 86 purchasing points; potential financial losses to the state due to lost opportunities for economies of scale; inconsistent application of purchasing procedures; inconsistent Request for Proposal, Request for Quotation, and contract provisions; unclear or imprecise specifications governing bidding; unmanageable vendor lists; inconsistent reporting and/or monitoring of vendor compliance with contract terms and conditions, and general evaluation of vendor performance; constraints on competition; and a range of personnel with different classifications and training. In addition to the problems associated with decentralization, there are problems with: the amount of time even a simple procurement might take; insufficient planning on the part of agencies confronted with "emergency" or "rush" procurements; incentives to encourage vendor creativity; inconsistent treatment of vendors; nonstandard contract language; and statutory provisions which appear to inhibit or prevent competition.

The report identified several recommendations to improve the efficiency of the purchasing system: 1) centralize the purchasing functions in DMB, with the exception of those dealing with building and transportation construction, and human services; 2) simplify the process; 3) require better planning by state agencies; 4) make purchasing language consistent; and 5) eliminate legal constraints.

In addition, the report identified several measures to improve vendor management and vendor relationships: 1) pre-qualify potential vendors; 2) develop a method to periodically cull the bidder's list; 3) limit bidding and responses to those who

have been prequalified; 4) develop a clear, quick method of resolving vendor disputes; 5) develop a method for vendor/contractor performance evaluations; 6) create a vendor relations ombudsman position; and 7) continue to encourage greater participation by small businesses and businesses owned by women, minorities, and handicapped persons. Finally, the report recommended the establishment of an ongoing, comprehensive evaluation system.

Update of PERM Activities. According to the *1994 Annual Report on Privatization* by the Reason Foundation, PERM analyses have been conducted on 38 functions performed by state agencies. Recommendations resulting from these analyses have included the sale of the Ann Arbor state armory and contractual services including medical and health services at state prisons, some data processing centers, highway road maintenance, and the inspection of fruits and vegetables. Other large privatization activities include the sale of the state's accident fund and closure of 66 state-owned liquor stores and three warehouses.

## Illinois

Private Enterprise Review and Advisory Board. On October 1, 1991, Governor Edgar issued an Executive Order which created a Private Enterprise Review and Advisory Board. The 24-member Board was directed to: 1) study the impact of having private enterprise perform activities currently undertaken by state government, where those activities are commonly provided by private enterprise; 2) study the impact of having state government perform activities currently under contract to business, where those activities would be better performed by state government; 3) assess complaints that especially small businesses have with the competitive practices of state government; 4) identify local government services with potential privatization possibilities and recommend a process for undertaking such evaluation; and 5) report to the Governor or General Assembly on or prior to March 1, 1993, outlining

the Board's activities, recommendations, and proposed legislation.

Report of Private Enterprise Review and Advisory Board. The Board focused its study on state agencies rather than local governments. Board members were divided into six subcommittees that matched the subcabinet groupings used in Illinois' annual budget process: Economic Development, Environment, General Government, Human Services, Public Safety, and Regulation. Each subcommittee examined the degree of privatization within its program area; identified obstacles and opportunities for further privatization; considered proposals for privatization and, where applicable, deprivatization; and outlined recommendations. The report included a list of more than 250 state government activities that were privatized in some way. This list did not include all services; the majority of services were performed under contract. The Board cited examples of successful privatization with highway construction and human service delivery. Other areas of state government, such as public safety agencies and regulatory agencies, were considered less conducive to privatization.

Privatization Activities After Report. According to a staff person in the Bureau of the Budget, all agencies are requested to consider privatization whenever a new program is to be implemented. In that manner, privatization, although not required, is connected to the budget process. Staff cited a recent example of privatization in the Department of Veterans' Affairs; one of the homes will be largely privatized. Staff considered privatization to be a means of survival for state agencies faced with ongoing budgetary constraints.

### Massachusetts

When Governor Weld took office in January 1991, Massachusetts was facing a budget deficit of \$1.8 billion. The Governor's response was to appeal to state managers to privatize government func-

tions whenever it would save money or improve services. This emphasis on privatization assumed the form of executive action rather than legislative mandate. The Executive Office for Administration and Finance developed a privatization manual for agency heads, including a "privatization checklist." The checklist includes such topics as minority business participation in bidding, workforce transition, public employee bidding, affirmative action, conflict of interest disclosures, and comparisons of fully allocated public versus private costs. Certain public services have been privatized since Governor Weld took office: prison health care; management of skating rinks; highway maintenance in several counties; rehabilitation of old housing for low and moderate-income families; child support enforcement; revenue management operation of the Department of Social Services; and housekeeping and dietary services at the facilities under the Department of Mental Retardation. In addition, eight state hospitals were closed.

Legislation -- Requirements of Privatization Contracts. Although the Weld administration reported a savings of \$273 million from privatization initiatives, the state employee unions apparently opposed this trend. Reports of jobs lost through privatization initiatives varied. According to the Weld Administration, 1993 privatization initiatives in health and human services left only 39 of 1,240 workers involuntarily unemployed. Of that total, 433 were transferred to other jobs, 383 were employed by private vendors, and 329 voluntarily left. According to the unions, in contrast, less than half of 1,000 human service workers affected by the first wave of layoffs were offered jobs by private contractors.<sup>1</sup> In December 1993, legislation was enacted with union support over Governor Weld's veto to give the state auditor approval power over future privatization efforts. The law provides that all privatization bids include a statement of the minimum wage rate to be paid for the position.

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<sup>1</sup> Elaine Stuart, "Privatization: Bay State Brawl," *State Government News*, February 1994, page 21.

That rate must be comparable to that of a regular agency employee or the average private sector wage rate for the position. In addition, the health care insurance benefits to be provided by the bidder must be comparable to those offered to state employees. Furthermore, the law directs state agencies to assist state workers who wish to bid on state jobs. The intent of the new law is subject to debate. Whereas legislative sponsors claim that it was enacted to regulate privatization, Administration spokespersons contend that it was enacted to stop privatization. Pursuant to the passage of the 1993 bill, the state auditor has issued guidelines to govern privatization activities. Since the law was enacted, there has been little privatization activity in Massachusetts. An exception is the Massachusetts Bay Transportation Authority which proceeded to contract out for the renovation of certain rail lines. The employee's union filed a preliminary injunction.

Purchase of Service Task Force. The Weld Administration convened a Purchase of Service Task Force to recommend improvements to the procurement system. The Task Force submitted both short-term and long-term recommendations to the Administration. The short-term recommendations concern: related party transactions and possible overbilling; quality of care and consumer satisfaction; stability of critical services; oversight; standards; and conflict of interest. An Executive Order prohibits private contractors from hiring state employees who were involved in preparing, negotiating, or supervising privatization contracts for the Commonwealth.

## Maryland

On February 1, 1993, Governor Schaefer issued two Executive Orders. The first order required the Department of Budget and Fiscal Planning to: 1) assure that the existing budget process be used for continuous evaluation of privatization; 2) evaluate alternatives to privatization proposed by each agency; 3) oversee cost comparison procedures for public versus private tasks; and 4) re-

view specifications and evaluations criteria. For their part, state agencies were directed to review privatization as an alternative to new and continued budget appropriations and to consider competing with the private sector to perform certain duties.

The second order established the 17-member Governor's Advisory Council on Privatization. The Council's responsibilities were to: 1) review and evaluate unsolicited privatization proposals; 2) provide information on privatization issues and offer procedural and implementation assistance; 3) provide oversight to ensure fair, comprehensive, and objective comparisons of privatization alternatives; 4) request status reports from state agencies on implementation efforts for privatization; and 5) request that state agencies conduct thorough evaluations of specific privatization opportunities. The second order also directed the Council to submit an annual report to the Governor on or before December 15, 1993 on privatization activities being considered or implemented.

Privatization Reports. In December 1993, the Governor's Advisory Council on Privatization issued an annual report identifying privatization initiatives. The report covers 42 state agencies, divisions, and campuses and provides a brief overview of each entity's mission, its FY 1993 operating and capital expenditures, and a detailed breakdown of expenditures that went directly to and from the private sector. For example, the Maryland Department of Juvenile Services reported an FY 1993 operating budget of \$96,122,561 and a capital budget of \$6.9 million. Approximately 44 percent of the operating budget and all of the capital budget went directly to the private sector. In addition to the annual report, the Governor issues quarterly reports identifying privatized projects implemented, projects under assessment and review, and projects withdrawn. The section on projects implemented identifies the Department, the function, and briefly explains the privatized activity. The section on projects under assessment/

review identifies the Department, the function, whether legislation is required, the project's status, and the projected date of completion of the assessment, negotiation, request for proposal, or selection of consultant. The section on projects withdrawn identifies the Department, function, and explanation of reason for rejecting the privatization option.

Methodology to Evaluate Privatization Opportunities. State agencies are asked to evaluate privatization opportunities as part of the budget submittal process. Privatization, in this context, includes contractual services; acquisition, construction, or operation of facilities; and underutilized assets. The process of evaluation includes four steps: 1) analysis of the potential for privatization; 2) examination of the cost of the activity to the government; 3) planning the necessary procedures; and 4) implementation.

For the analysis of potential opportunity for privatization, 13 questions are posed to ascertain whether more specific and serious scrutiny is warranted. For the examination of costs to the government, three factors need to be considered over a projected five-year period: a) what it costs the government to perform the activity; b) what it would cost government to monitor the activity; and c) what future costs could be avoided by transferring the activity to the private sector. Costs to be considered include personnel costs, operating costs, capital costs, insurance and liability costs, allocated administrative costs, management and supervision costs, and other costs.

For the planning function, the agency needs to evaluate the parameters of the proposed privatization effort. Such evaluation must include timing, personnel, cost, agency impact, and other factors. For the implementation phase, the agency must: prepare the Request for Proposal or proposal specifications; conduct procurement negotiations; review responses to the Request for Proposal; compare costs of the private alternative to that of the public sector alternative; establish an

oversight procedure; and, if applicable, transfer the activity to the private sector.

Government Efficiency 2000 Commission. The 1994 Legislature enacted H.B. 1214, which established a 25-member commission to assess government policies and practices and advise the public on how to increase government responsiveness and accountability. The Commission will consist of two representatives of the executive branch, four legislators, two representatives of the judicial branch, seven representatives of the business community, two representatives of organized labor, two representatives of higher education, two representatives with local government experience, and four representatives of the general public.

Among its statutory responsibilities, the Commission is required to encourage the development of proposals for the privatization of select public services and to determine the extent to which the delivery of public services could be competitively bid with the private sector. Another charge to the Commission is to examine records and gather data relating to the contracting and purchasing policies, organizational structure, budget and finance, and personnel policies and practices of governmental units of interest to the Commission. H.B. 1214 takes effect on July 1, 1995.

## Colorado

Enabling Legislation. The 1988 Legislature enacted legislation, which is explicitly based on the premise that "state government competes with the private sector when state government provides certain goods and services to the public." The law expressly prohibits state government from engaging "in the manufacturing, processing, sale, offering for sale, rental, leasing, delivery, dispensing, distributing, or advertising of goods or services to the public which are also offered by private enterprise unless specifically authorized by law." Exceptions to this prohibition include state parks, historical monuments, and certain other recreational facilities; correctional institutions;

state veterans' homes; the state tourism board; printing and copying activities under certain circumstances; public safety; state transportation facilities; free medical services and equipment; and activities of the regional transportation district transit construction authority.

The legislation also prohibits institutions of higher learning (universities, colleges, and community colleges) from providing to persons other than students, faculty, staff, and invited guests through competitive bidding goods, services, or facilities that are available from private enterprise. This prohibition does not apply to the provision of goods, services, or facilities that offer students a valuable educational or research experience. The law specifies the criteria that should govern that determination and allows institutions of higher education to adopt their own procedures, in accordance with Commission guidelines, for hearing complaints by privately-owned businesses. The law further establishes a procedure for business complaints to be addressed by the advisory committee to the Office of Regulatory Reform, discussed below.

Advisory Committee to the Office of Regulatory Reform. The Advisory Committee to the Office of Regulatory Reform is composed of 13 private-sector business representatives. Persons who believe that a state agency has violated the provisions of the 1988 law are authorized to file a written complaint with the Committee stating the grounds of the complaint. The Committee is required to receive such complaints and forward them to the appropriate state agency. For its part, the state agency must respond to the Committee within 45 days after receipt of a complaint and either admit or deny the allegations and indicate whether remedial actions will be taken. The majority of the Committee must determine whether to hold hearings on complaints and the majority must determine whether the state agency is violating the law. Within 60 days after the response, the Committee is required to report its findings to the complainant and the state agency. There is a

provision in the law for annual reports from the Committee. The law prohibits retaliation by a private sector enterprise against an employee who discloses information concerning that private enterprise. An employee has recourse to a civil action in the event that retaliation is considered to have occurred. Since the enactment of the 1988 law, only one of five complaints investigated by the Committee and subject to a Committee determination actually resulted in a change to a state agency's practice. In a case involving the Colorado Geological Survey, the allegation was made that the Survey had competed unfairly against the private sector by including in bids only direct costs (and not both direct and indirect costs) for engineering services to municipalities. Pursuant to the Committee's determination that this constituted unfair competition, the Governor issued an Executive Order directing the Survey to include in its bids both direct and indirect costs.

Legislation Not Enacted But Considered. After 1988, there have been two other efforts to amend the enabling legislation. The most recent attempt was H.B. 1263, a bill that was considered, was passed by one house, but was not enacted by the 1993 Legislature. The bill would have required government entities to notify private business owners if those entities planned to provide a new good or service subject to the approval of a reviewing authority (city council, county commission, or the Colorado Office of Regulatory Reform). The complaint procedure in the 1988 law would have been amended to replace the Advisory Committee to the Office of Regulatory Reform with references to the "reviewing authority." Moreover, in contrast to existing law, the complainant (and not the majority of the Advisory Committee) could have demanded a public hearing. The notification and review activities in H.B. 1263 would have had to precede the delivery of such state or municipal good or service. The criteria forming the basis of the reviewing authority's decision were included in the bill. According to a staff person at the Department of Regulatory Agencies, the bill was defeated because of opposition

from the Colorado municipalities. An effort is presently under way to gather signatures to put an initiative on the ballot calling for a constitutional amendment to codify a version of H.B. 1263.

#### Problems With the Privatization Legislation.

Since the legislation was enacted in 1988, five complaints have been investigated on grounds of unfair competition. In some cases, the determination was made that the agency, which was alleged to have competed unfairly, had express statutory authority to carry out the function (water testing and Geological Survey). In other cases, the agency was exempt from provisions in the privatization legislation. One part-time position is assigned to an investigation of complaints, and there is an average of one complaint a year. Businesses have been hesitant in the past to file complaints against regulators due to fear of reprisal. The staff contact observed that if complaint proceedings could be initiated informally, staff could pursue those investigations more easily. Moreover, in staff's view, the enabling legislation would be strengthened if there was public representation and if the Advisory Committee were made accountable to an appointed or elected official. In addition, the Advisory Committee has little enforcement authority. Its sole recourse is to write reports of an advisory nature.

#### **Implications of State Experiences**

The following observations are based on states' experiences with privatization:

**Define the Problem.** States vary in their definition of the problem and that difference in definition affects a state's approach to promoting business competition. For example, the legislative declaration in the Colorado law asserts that:

State government competes with the private sector when state government provides certain goods and services to the public. Recognizing this *problem*, it is the intent of the General Assembly and

the purpose of this article to provide additional economic opportunities to private industry and to regulate competition by state agencies, including institutions of higher education (italics not in statute).

In Colorado, the process developed to redress alleged problems with unfair competition is through a business-initiated complaint process.

In contrast, the underlying assumption in Maryland's effort is articulated in one of the Executive Orders issued by Governor Schaefer:

The State should consider which sector, public or private, will be the more effective at increasing efficiency, improving quality, or reducing the cost of particular operations.

The methodology developed by Maryland to evaluate privatization opportunities contains the following quotation from *Reinventing Government* guru, David Osborne:

Business does some things better than government, but government does some things better than business. The public sector is better at policy management, regulations, ensuring equity and preventing discrimination and exploitation. Business is better at innovating, replicating successful experiments, adopting to rapid change, and aborting unsuccessful or obsolete activities.

**Emphasize Competition.** Much of the literature on privatization recognizes the importance of competition in making determinations about the most appropriate method of service delivery. According to one source:

Savings through contracting are not inevitable. Some jurisdictions, in fact, contract out specifically because they can bypass government regulations and pay contractors more than they can pay civil servants. Contracting therefore can actually cost more than government-operated programs. When savings result, however, they

are most likely to come from the pressures of competition.<sup>2</sup>

Cost savings would not necessarily be realized, however, if the private sector contractor becomes a monopolist to which the government is held captive. States with privatization procedures appear to acknowledge that danger. John Kost of Michigan informed staff that the PERM process would only be activated if there was more than one private sector provider for a given public sector service.

**Identify Goals and Measurable Results of Services.** Texas' initial study of five services underscores the point that goals might be easier to identify for certain services (e.g., computer support services and outgoing mail) than for others. When initiating a privatization review procedure, a state may be advised to select services with clearly articulated goals and easily measured outcomes. Certain social services might be more problematic in this respect because the goals for privatization may be difficult to define; the "customers" and "owners" of the service may not be easily identified; social service contracts might be more likely to include input and process measures than outcomes measures; and there may be little competition among service providers.

**Integrate Privatization Review Procedures With the Budget Process.** Texas, Michigan, Maryland, and Illinois have policies in effect which, in some manner, integrate prospective privatized services with the state budget process. In Texas, the statutorily established Council on Competitive Government has express authority to recommend reductions to the Legislative Budget Board. In Michigan, the final PERM analysis is linked to the budget process and competitive bidding process. State agencies send their completed PERM analyses for review to the Privatization Division in the Department of Management and

<sup>2</sup> Donald F. Kettl, *Sharing Power: Governance and Private Markets*, Washington D.C.: The Brookings Institute, page 163.

Budget. In Maryland, the Governor's Executive Order requires the Department of Budget and Fiscal Planning to "assure that the existing budget process be the mechanism to ensure the continuous evaluation of privatization." In Illinois, the Private Enterprise Review and Advisory Board had determined programs that were candidates for privatization and de-privatization. Agencies with such programs were requested in their instructions for budget submittal (FY 1994 and FY 1995) to provide a schedule to the Bureau of the Budget for moving forward with privatization. In contrast to the above examples, Colorado's use of an advisory committee illustrates that privatization bodies not linked to the budget procedure are essentially ineffective.

**Ensure the Accuracy of Methodologies for Comparing Costs of Public and Private Sector Services.** Texas, Michigan, Massachusetts, and Maryland have developed cost methodologies for comparing public and private sector services. It is important that any methodology adopted in this state take into account direct and indirect costs, internal operation costs, costs of monitoring and regulatory oversight, costs of making the transition from the public sector to the private sector, and costs, if any, of resuming governmental production. Despite the components needed for making such comparisons, one should also ensure that cost analyses compare relevant fields. For example, a comparison between wages and benefits for public sector and private sector employees is likely to be misleading if the benefit compensation packages are not carefully defined and adjustments are not made for differences. Comparisons are also misleading if there is no further adjustment made for differences in education, experience, and occupation.<sup>3</sup> Another consideration is ensuring that quality of service is comparable. For example, in making comparisons between

<sup>3</sup> See analysis of public employee compensation in comparison with private sector compensation in Dale Belman and John Heywood, "The Truth About Public Employees: Underpaid or Overpaid?" Washington D.C.: Economic Policy Institute, June 11, 1993.

nonprofit and private psychiatric hospitals, researchers used the indicator of psychiatrist-hours per week per patient and, as a surrogate measure, the range of services available under a particular production arrangement (facilities that provide educational or vocational services).<sup>4</sup>

**Ensure That Contracting Governments Have Sufficient Capacity and Adequate Resources to Monitor Projects.** State oversight of contractual projects is critical. States must have the necessary staff and resources to collect and evaluate performance data of a program independent of the provider's efforts to undertake that responsibility. Examples of inadequacies in monitoring are the failure of two Michigan state departments to conduct on-site inspections and rely instead on self-reporting by contractors. Another example is the payment in Massachusetts to contractors who delivered no services at all. An independent and impartial analysis is crucial for the continued credibility of the state's privatization process and is important for ensuring actual cost savings and for identifying problems that might occur.<sup>5</sup>

**Recognize the Importance of Educating the Public.** The privatization procedure could engender opposition from public employees. Public employees fear that privatization will mean either a loss of their jobs or a reduction in pay and benefits. There are several ways to mitigate this fear. First, contractors could be required to give the current government employees the right to first refusal of all or most of the jobs and contracts. Second, jobs might be given only to current employees or might be given to them only for a set period of time, unless otherwise extended. Public employees might be assisted in forming companies to take over work previously performed

<sup>4</sup> This study of mental health service providers was conducted by M. Schlesinger and R. Dorwart in 1984. The methodology was summarized in: Randy L. Ross, *Government and the Private Sector: Who Should Do What?* New York: Crane Russak & Company, 1988, pp. 78-79.

<sup>5</sup> Donald F. Kettl, *Sharing Power: Public Governance and Private Markets*, Washington D.C.: The Brookings Institute, 1993, p. 175.

in-house. Massachusetts is a good example of a state that initiated the privatization effort in an adversarial manner with major repercussions -- enactment of a law that markedly decelerated the pace of privatization. By contrast, Maryland has proceeded with its privatization efforts in a more cautious manner, emphasizing privatization as one of several tools to increase government efficiency. Maryland's reporting procedure serves as a means of educating employees and businesses about privatization opportunities.

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## COST ACCOUNTING

### Importance of Cost Accounting

While the Kansas Council on Privatization has wrestled with various definitions of its overall objective, a common thread through all discussions is an interest in improving government efficiency. Efficiency translates into either gains in quality or reductions in cost, or both. Privatization is just one means by which that can be accomplished. Consequently, the Council has considered other efficiency-enhancing options such as the elimination or modification of services now performed by state government.

None of these alternatives can be reviewed in a meaningful way without an honest and accurate discussion of money. How much does it *really* cost for state government to perform a given function? How much would it *really* cost the state to have one of its given functions performed instead by a private sector business? It is imperative that these questions be accurately answered before the state decides to privatize, eliminate, retain or modify (PERM) any of its services.

When inquiring about the amount of state funds dedicated to a single state program, for example, a taxpayer will probably receive no more than a listing of line-item appropriations which the Legislature has authorized for that program. Some direct and many indirect costs associated with the program will likely be excluded from that tabulation. This subject will be discussed in detail below, but some typical examples of excluded program costs are state employee pensions, facilities and capital equipment expenses, interest costs, and various indirect overhead costs.

Cost, however, is only one of the two analytical elements. Although it is beyond the subject of

this chapter, we mention the desirability of establishing some method for objectively measuring the quality of state services and their proposed private sector substitutes. This concept is frequently mentioned in the context of plans for "outcomes-based budgeting" of state funds. It would involve an exhaustive review of most state programs and services in an attempt to set quantifiable benchmarks of performance.

Legislators have expressed an interest in outcomes-based budgeting and state financial administrators have already begun to include quality measurements into their annual evaluations. The task is immense and will take several years to fully implement. Doubtless, a similar objective quality assessment will eventually be applied to services proposed by all private sector bidders. In the short-term, subjective opinions of quality will predominate and must suffice.

Fortunately, full and accurate cost comparisons between the private sector and public sector are more readily obtainable than measurements of quality. Not only is such financial data indispensable to a PERM analysis, it also has an independent benefit. There is an inherent advantage in quantifying the true full cost, i.e., "fully allocated cost," or "direct plus indirect cost," of any state program, service or function. Taxpayers deserve the information even if it does not lead to, or justify, any change in the status quo.

### Current Status of Agency Accounting Practices

Minimum state agency accounting responsibilities. State agencies, in practice, are asked to perform that degree of cost accounting which is sophisticated enough to facilitate preparation of the annual state budget. They are obligated by state

law to perform an accounting which is in accordance with "accepted principles of governmental (fund) accounting" (APGA) (K.S.A 75-3728). The private sector counterpart to those principles is "generally accepted accounting practices" (GAAP), but the two standards are substantially similar and for our purposes the difference is not relevant. Neither APGA nor GAAP specifies the degree of detail in which records must be kept. In other words, an agency's failure to record expenses on a project-by-project basis (for example) would violate neither APGA nor GAAP if the agency's aggregate expenditures (which may include many specific projects) were recorded in proper fashion.

The Division of Accounts and Reports in the Kansas Department of Administration (KDOA) is responsible for formulating a central accounting system and maintaining central accounting records. The Division must design, revise, and direct the use of accounting records and fiscal procedures and prescribe uniform classifications for the many types of receipts and expenditures of all state agencies. (*Ibid.*)

The Division maintains agency accounting data in a computer system referred to as STARS (State-wide Accounting and Reporting System). Every agency's receipt and expenditure data must be recorded in STARS. Most of the largest state agencies have on-line capability and directly enter the data into STARS. Smaller agencies can exercise on-line capability, and some do. Other agencies, generally those with fewer transactions, submit their expense and receipt data to KDOA on either paper forms or magnetic tape. KDOA then transfers the paper or tape data into STARS.

Regardless of which communication mode is selected, all agencies must provide their data in accordance with a basic encoding scheme set forth by KDOA. Following are the required categories of codes which must accompany every financial data entry into STARS:

- Agency/Division #
- Fund #
- Fiscal Year #
- Budget Unit #
- Program Cost Account #
- Expenditure or Revenue Sub-Object #
- Transaction Code #

Of these categories, the budget unit number and the sub-object codes are of most relevance to cost accounting interests. The *budget unit* number identifies the line-item appropriation authorized by the Legislature. The aggregate agency expenditures attributed to a given budget unit may not exceed the dollar amount specified in legislation.

*Sub-object codes* are 4-digit numbers that describe broad types of expenditures. These consist of eight primary expenditure classifications: 1) salaries and wages; 2) contractual services; 3) commodities; 4) capital outlay; 5) grants, claims and shared revenue; 6) debt service; 7) non-expense items; and 8) non-expense items that are investments by the Kansas Public Employees Retirement System. Each of these eight primary classifications, in turn, has further detail.

For example, a 4-digit sub-object code number that begins with "1" would be in the salary and wages classification. If the full number is "1510", the expenditure is for compensation to legislators. "Legislator compensation" is one of 35 specified types of salary and wage expenditures.

Agencies must have their expenditures approved through KDOA before KDOA issues a check for payment. KDOA's Administrative Audit Section receives daily requests for payment approval. Those requests may be received from an agency on paper forms, on magnetic tape, or are sent to KDOA directly on-line through STARS. As mentioned above, the primary purpose for this system is to ensure that money is spent from the proper categories (line-item appropriations) authorized by the Legislature and that each category's legislative appropriation is not exceeded.

Varying levels of detail in agency accounting.

Apart from the mandatory and typical level of STARS usage, there is another stratum of STARS capability; several *optional* coding categories and additional services are available on STARS for the use of state agencies. Following are permissive categories of codes which may accompany each financial data entry into STARS and some additional accounting functions which STARS can perform:

- Encumbrance #
- Index Code #
- Grant Accounting
- Project Accounting

Index codes and project accounting include the higher level of financial detail needed to produce an analysis of a given service's true full cost, but *project accounting* is rarely utilized. According to KDOA personnel, only one agency -- the Kansas Department on Aging -- has expressed an interest in coding its transactions on STARS by referencing the specific projects to which given expenditures are attributed.

However, *index codes* are now used by both large and small state agencies. There are no statewide criteria or definitions regarding the subject matter of index codes. Agencies develop their own index codes to suit their specific needs and there is no consistent application of index codes from one agency to another.

Index codes are typically used to document the specific fund or account from which an expenditure is made, the specific activity for which the money is spent, or any other "cost center" the agency wishes to monitor. To illustrate, the Legislature may approve a line-item appropriation for Agency X which is assigned a budget unit code number; Agency X may choose to designate 50 different index codes (or perhaps only two) to this budget unit, each index code representing a distinct type of expenditure permitted of the funds in the budget unit. While mandatory sub-object

codes outline broad spending categories, index codes subdivide that spending even further. To distinguish, a sub-object code may label all of Agency X's expenditures for employee travel, but relevant index codes may identify the projects they were working on which necessitated the travel.

There are almost 100 different types of *STARS reports* that the network is capable of generating. Some are requested daily, some are never used, and there are varying degrees of confidentiality which apply to one report or another. Examples of STARS reports are the "project expenditure analysis," "daily cash balance report," "expenditures by fund, index, PCA, and sub-object," and "project transaction analysis." Financial data referenced by index codes are available from those agencies which employ them.

Index coding is not employed by all state agencies in Kansas although its use is very significant. Some of the characteristics of those agencies which use it are: imposition of user fees on the public for specific state services rendered; a relatively large number of employees; and/or receipt of federal funds.

Agencies which exercise authority to impose user fees tend to keep a more elaborate accounting of their expenditures. They must justify the amount of their fees and cannot do so without a record of the full costs attributable to the charged service in question.

Agencies staffed with a relatively large number of state employees tend to keep a more elaborate accounting of their expenditures for a variety of reasons. First, they have more personnel to devote to their accounting needs. Second, their size brings with it an organizational complexity that makes a specific cost accounting more useful. When an agency has many divisions and subdivisions, the odds substantially increase for inter-departmental sharing of personnel and resources. This feature raises the value, for managerial purposes, of knowing the detailed allocation of re-

sources. Furthermore, large agencies are more likely to have authority to impose user fees and are more likely to be recipients of federal money.

KDOA itself exemplifies those characteristics and has thus adopted sophisticated accounting practices. Obviously, its role as the state's central accounting service requires a high degree of expertise in this matter. Its relatively large size has also justified full cost accounting for the reasons mentioned above. Another motivation is the interagency nature of the services which KDOA performs. Most of the wide variety of the work done by KDOA is for the benefit of other agencies, e.g., architectural, legal services, accounting, and procurement functions. No other state agency assumes a support role to other agencies; in fact, Kansas agencies (other than KDOA) rarely incur costs which are allocable to other state agencies. The interagency expenses borne by KDOA compel KDOA to monitor fully allocable costs for managerial reasons. Every year, KDOA drafts a notice to each state agency informing it of the value of services KDOA has performed on its behalf. Although the value of such services is comparable to their fully allocated cost, it is actually "value" as defined by federal cost allocation plan standards which are discussed below. The federal standards provide that some costs are excluded from the computation.

However, the dominant reason for a typical agency's use of full cost accounting is that the federal government requires it of them. Receipt of federal funds usually compels an agency to develop a cost allocation plan as prescribed by federal regulations.

Federal cost allocation plan (CAP) standards. Almost eight years ago, the federal Office of Management and Budget (OMB) promulgated regulations regarding standardized cost principles for governmental units. Referred to as OMB Circular No. A-87, these standards are the product of an interagency task force established in 1987 to review cost principles for federal awards to state

and local governments. Actually, the 1987 regulations were a modification of similar federal standards in place since 1968.

Public comment on suggested amendments to "Circular 87" were solicited in 1988 and again in 1993. The review in this chapter will refer to the form of those regulations as proposed in August of 1993. (OMB Cost Principles for State and Local Governments, 58 Fed. Reg. 44212, proposed August 19, 1993.) Our discussions with Kansas administrative officials revealed that they typically adhere to the latest published federal guidelines, including any proposed changes. Proposed alterations of the original Circular 87 have been relatively minor and, as noted below, even the officially adopted regulations may be subject to negotiation on a case-by-case basis.

The scope of application of federal cost accounting principles is as follows:

These principles will be applied by all Federal agencies in determining costs incurred by governmental units under Federal grants, cost reimbursement type contracts, and cooperative agreements (including subgrants and subcontracts) except those with: 1) publicly-financed educational institutions subject to Office of Management and Budget Circular A-21, and 2) programs administered by publicly-owned hospitals and other providers of medical care that are subject to requirements promulgated by the sponsoring Federal agencies. However, this Circular does apply to all central service and department/agency costs that are allocated or billed to those educational institutions, hospitals, and other providers of medical care or services by other State and local government departments/agencies. (58 Fed. Reg. 44215, 1993.)

Thus, the receipt of federal funds leads to imposition of the cost accounting standards outlined in

various provisions of Circular 87. The heart of those requirements is the need for a recipient state or local government entity to develop a Cost Allocation Plan (CAP).

A CAP is the process for documenting, identifying, accumulating, billing, and distributing the allowable costs of services provided by a governmental entity in support of federally funded activity. (See *Ibid.*, 44216.) The CAP must account for the *total costs* associated with the services in question. The term *total costs* is defined as the allowable *direct costs* of the service, plus the allocable portion of allowable *indirect costs*, less applicable credits. (*Ibid.*, 44217.)

A state agency's CAP must annually be developed and submitted to the appropriate federal agency for approval. In the case of the Kansas Department of Administration and Social and Rehabilitation Services, that reviewing agency is the Federal Department of Health and Human Services. State agencies typically submit two or three versions of their annual CAP proposal before it is finally approved by the federal government. KDOA contracts with a private accounting firm to prepare its CAP proposals while SRS develops its CAP proposals internally.

The form and contents of a CAP is regulated by the terms of Circular 87. The regulations set forth standards regarding: the allowability of costs; the distinction between direct and indirect costs; a lengthy non-exclusive list of cost factors which must be incorporated into a CAP proposal; the degree of CAP conformance to generally accepted accounting principles; the documentation, negotiation and approval process for submitted CAPs; and many other relevant provisions. An outline of the contents of Circular 87 is presented in Appendix 4.

Of course, the main purpose of a CAP is to quantify the amount of federal participation money to which an agency is entitled. CAP development is tedious and expensive; yet there are few alterna-

tives which allow state agencies to receive federal money without embarking on a lengthy CAP analysis.

For example, Circular 87 permits a standard indirect cost allowance for the provision of an inter-agency service. (58 Fed. Reg. 44218, 1993.) That means KDOA could elect to receive a standard amount of federal money (equal to 10% of direct wage and salary costs) for a given service it provides to other state agencies. KDOA, in this hypothetical example, would have to decide whether it is better to receive the standard amount in lieu of the amount a fully developed CAP would justify. The decision is comparable to that of a person choosing between a standard deduction or itemized deductions on a federal income tax return. Although an itemized income tax return may result in a higher overall deduction, the time and expense involved may not be justified. Similarly, state agencies must weigh the cost of CAP development against the potentially higher federal dollars a CAP may bring them.

There are other circumstances in which a CAP proposal may be modified. Upon review of a CAP proposal, the federal government may either disallow all indirect costs or unilaterally establish such a plan or rate. (*Ibid.*) More typically, the reviewing federal agency will negotiate the indirect cost rates included in the state agency's CAP proposal. Where there is a reasonable assurance based on past experience and reliable projections of a recipient state agency's costs, long-term agreements utilizing predetermined indirect cost rates are encouraged. (*Ibid.*, 44233.)

Some state agencies, therefore, have an incentive to report the highest level of indirect costs attributable to their services. If the federal government deems those costs to be allowable, the state agency reporting them within their CAP will receive more federal money. The notice (referred to above) which KDOA annually sends to each agency is an example of indirect costs that are usually compensated, at least in part, with federal funds. How-

ever, KDOA does not bill any state agency for those KDOA-provided services and the Legislature does not include the cost of the services in the budgets of the respective agencies. The notices are sent by KDOA for informational purposes and to allow state agencies to maximize their federal funding.

There are isolated examples of other states that have employed a detailed cost allocation system successfully to increase their share of federal funding. Kansas is one such state that uses the technique on a limited scale. However, Texas has implemented, and Michigan is in the process of implementing, a comprehensive computer system into which is recorded in a uniform manner total cost data for all state agencies.

### **Other States' Experience with Cost Accounting Reforms**

Texas. In 1993, the Texas Legislature passed an act establishing the State Council on Competitive Government. The Council is identified as a subdivision of the state comptroller's office and it supervises a host of efficiency-improving state initiatives, including privatization efforts and their necessary cost analyses. Moreover, the Council is responsible for instituting the cost accounting methods to be employed by Texas agencies.

Texas decided to embark on a comprehensive revision of its cost accounting system. The Council solicited bids for a new computer system to record detailed cost data pertaining to all state agency expenditures. The winning bid of approximately \$20 million was jointly submitted by the accounting firm of Peat Marwick & Associates and the computer specialists of Electronic Data Systems, Inc. Their contract included the supply of computer hardware, software, consulting and personnel education needed to implement the new accounting system.

Known as the Uniform State Accounting System (USAS), this Texas network closely parallels Kan-

sas' STARS network. According to representatives of Electronic Data Systems, the two computer networks share the same hardware and software, but differ in their "relational databases." This difference is manifested in the comprehensive uniformity of the Texas system. Each Texas agency must code its expense data into USAS using the same detailed and well defined coding categories that are used by every other agency. The process of defining uniform cost categories with a high degree of specificity has been difficult and time consuming. Texas agencies hold legitimate and often conflicting opinions about the most appropriate coding schemes and cost allocation rates. This is the same type of problem encountered by state agencies that pursue federal CAP approval and which often necessitates negotiation with the governing federal entity.

Kansas' STARS network imposes a lesser degree of coding uniformity upon Kansas agencies. KDOA defines the mandatory sub-object codes, but neither defines nor requires the more elaborate index codes which better facilitate an accurate accounting of total costs. However, STARS does have that capability and it is now being utilized at the initiative of various Kansas agencies.

Michigan. Michigan, too, has recognized the value of a uniform computer accounting system. Its privatization efforts continue as the result of an executive order by the governor, rather than through legislative action as in Texas. However, the course of action in both states has been remarkably similar. Both extend their analysis beyond privatization options alone and consider a variety of methods by which government efficiency can be enhanced. Both also acknowledge the importance of total cost accounting in accomplishing that goal.

Consequently, Michigan began implementing its own version of USAS on October 1, 1994. Bids were solicited and, again like Texas, the contract was awarded jointly to an accounting firm and a

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computer systems firm. The system which is the Michigan Administrative Information Network (MAIN) will be installed gradually over the next six years at a cost of roughly \$100 million. The expense of this system is greater than that of the Texas project because Michigan had a lower level of computerization at the outset. MAIN will ultimately be comprised of R-STARS (like the Kansas system), an advanced purchasing and inventory control program, and other software which provides for a comprehensive modernization of Michigan's record keeping. MAIN is not yet being used to analyze cost data for privatization analyses.

### Elements of an Accurate Cost Assessment

Some of the ideas found in the literature of government cost accounting are subject to debate. Usually, when a difference of opinion arises, it pertains to the methodology used to allocate indirect costs. However, most of the relevant concepts have widely accepted definitions which differed in no substantive way throughout our research of this topic.

We found a concise and reliable summary of these principles in a publication distributed by the Reason Foundation, *How to Compare Costs Between In-House and Contracted Services*, authored by Dr. Lawrence Martin (March, 1993). Similar reports issued by the states of Texas, Michigan and Colorado, and regulatory definitions promulgated by the Federal Office of Management and Budget, presented no inconsistencies. The balance of this section is quoted directly from Dr. Martin's article.

The total cost of providing a target service in-house, also known as the *fully allocated cost*, is the sum of its direct costs plus a proportional share of organizational overhead, or indirect costs. When the direct and overhead costs of a target service are identified, the resulting dollar amount constitutes the fully allocated cost, or total cost, of providing a target service in-house.

Direct costs. Direct costs are those cost items that only benefit, and thus are totally (100%) chargeable, to a target service. Examples of direct costs include the salaries, wages, and fringe benefits of government employees who work exclusively (100%) on the in-house delivery of a target service, as well as the costs of supplies, materials, travel, printing, rent, utilities, communications, and other costs consumed or expended for the exclusive benefit of a target service.

Some direct cost items are routinely overlooked when the cost of providing a target service in-house is computed; thus, they warrant special mention: interest costs, pension costs, and facility and equipment costs.

Interest on capital items purchased for the exclusive (100%) use of a target service through a bond issue or other financing arrangement should be included as a direct cost of in-house service provision. For example, a fire truck purchase that is financed will typically take interest payments from a local government's general fund, but this cost should be counted toward the cost of fire protection services.

The pension costs of government employees who work exclusively (100%) on a target service should be included as a direct cost of in-house service provision regardless of whether the government fully funds the pension plan or not. Unfunded and underfunded pension plans defer, but do not avoid, these costs.

Facilities and capital equipment used exclusively (100%) for a target service should also be included as a direct cost of in-house service provision. Depreciation costs can be computed, or, if depreciation is not appropriate or no depreciation schedule exists, a use allowance factor can be computed. Even when no actual cost is incurred, a use allowance factor should still be included because the asset could be used for other government purposes or sold.

Indirect costs. Overhead costs, or indirect costs, are cost items that benefit the target service and at least one other government service, program, or activity. The expenses of various administrative and support services provided to a target service by other governmental departments are overhead costs. Examples include: salaries, wages, fringe benefits, supplies and materials, travel, printing, rent, utilities, communications, and other costs that benefit the target service and at least one other government service, program, or activity. A check should also be made to ensure that overhead costs include applicable interest costs, pension costs, and depreciation or use allowance costs on shared facilities and equipment. If not, these costs should be added to applicable overhead costs.

Overhead costs are generally apportioned among government services, programs and activities according to some allocation scheme. The most common methods are "personnel costs," "total direct costs," and the "step-down" method. The personnel-cost method assumes that overhead costs are proportional to the number of employees (or full-time equivalent employees). The total direct cost method assumes overhead is proportional to the budget of the target service. And the step-down method divides all departments into either support or production departments, and works by allocating all the costs of support departments to the other entities they serve.

Many state and local governments have automated accounting systems capable of identifying, tracking, and allocating overhead costs. Frequently, state and local governments develop overhead or indirect cost rates that are simply applied to the personnel or total direct costs of a target service.

Avoidable vs. unavoidable costs. The use of fully allocated costs is generally inappropriate in estimating the *savings* to be realized by contracting out a target service that is currently being conducted in-house. In other words, the amount of money that is likely to be saved is not simply the

difference between fully allocated in-house costs and the total contracting cost.

This is because contracting out does not generally result in a dollar-for-dollar reduction in governmental overhead costs. For example, the contracting out of a target service, or a portion thereof, may result in decreasing the workload of service departments like personnel, finance, and facilities management, but the workload reductions may be insufficient to have any significant effect on the costs of maintaining these departments. When attempting to determine the potential cost savings associated with the contracting out of a target service, the appropriate in-house costs to use in the comparison are the "avoidable costs."

Avoidable costs are those in-house costs that will not be incurred if a target service, or portion thereof, is contracted out. How-to contracting books, as well as several contracting-out guides prepared by state and local governments, recommend the use of avoidable costs when assessing the likely cost savings achievable through contracting out.

The use of avoidable, or incremental, costs is also the generally accepted managerial accounting approach to conducting the financial component of a business "make or buy" decision. Determining which in-house costs are avoidable is not a simple task. Of course, virtually all direct costs will be avoidable. But ascribing what portion of overhead costs is avoidable is a matter of judgment, and depends largely on three factors:

1. the determination of the public sector to reallocate resources efficiently;
2. the extent of the privatization effort, both in the target service area and in other services that employ the support of the same government departments; and
3. the time period in which resource allocation is expected to occur.



In the private sector, the decision to discontinue a particular function is usually accompanied by a swift reallocation of resources in support areas as well. The private sector has a strong incentive to reduce overhead as much as possible so as to maximize profits. By contrast, the public sector lacks such strong incentives due to the absence of profit motivations: the extent to which overhead costs can be avoided in the wake of contracting out is partly a function of political will.

The reduction in overhead costs is related to the extent of privatization. There is a cumulative effect to be considered, in that contracting out not only in the target service but in other services which make use of the same overhead support functions influences the potential for overhead reduction. For instance, contracting out a service with only five employees would be unlikely to reduce overhead by any appreciable amount, unless several other small programs were being contracted out as well. Several small contracts, which considered separately would have a negligible impact on overhead, could in the aggregate reduce overhead significantly.

Finally, there are many costs that cannot be avoided in the short-term that may be avoidable, however, in the long-term. For example, contracting out of a portion of transit service may leave a public entity holding a lease for more storage and maintenance capacity than is necessary. In the short-term, that cost may be unavoidable, but in the long-term the public entity could decline to renew the lease.

An emphasis on avoidable costs does not mean that computing the fully allocated costs of providing a target service in-house is a superfluous exercise. In order to determine the costs to be avoided by contracting out, one must first determine the fully allocated costs of in-house service delivery. In all cases, the figure sought after when estimating cost savings should be avoidable costs, minus total contractor costs.

Costs of contracting out. The total cost of contract service delivery is the sum of: 1) contractor costs, *plus*; 2) contract administration costs, *plus*; 3) an allowance for one-time conversion costs, *minus*; and 4) offsetting revenues.

*Contractor costs* may be the easiest component of contract service delivery costs to compute. Contractor costs are simply the total costs a contractor proposes to charge for performing the target service. Contractor costs can generally be taken directly from a contractor's bid or proposal.

*Contract administration costs* may be the most difficult component of contract service delivery costs to compute. Contract administration can be defined as all those activities that take place from the time a decision is made to contract out until the contract is fully executed and final payment is made. Contract administration costs include: procurement, contract negotiations, contract award, the processing of amendments and change orders, the resolution of disputes, the processing of contractor invoices, and contract monitoring and evaluation.

The two major methods in use for estimating the cost of contract administration are informed judgment and the Federal Office of Management and Budget guidelines.

Based on state and local government experiences with contracting out, the costs of contract administration have been assessed at between zero and 25 percent of contractor costs. At the low end of the cost range falls the County of Los Angeles, which computes the costs of contract administration at zero. In Los Angeles County, existing staff are assigned contract administration duties in addition to their regular job responsibilities. Consequently, the county maintains that no additional contract administration costs are incurred when a target service is contracted out.

Estimating the cost of contract administration at zero almost certainly underestimates the true cost.

Even when existing staff are used to perform the contract monitoring function, government departments such as purchasing and finance still experience workload increases with attendant cost implications.

At the high end of the cost range is the estimate of 25 percent of contractor costs derived from a major study of municipal contracting out in the greater Los Angeles area. The City of Phoenix, Arizona estimates the administration costs of its former sanitation contracts to be 16 percent of contractor costs. A growing body of evidence suggests that on average the true cost of comprehensive contract administration falls between the two extremes of zero and 25 percent.

Based on the judgments and experiences noted above, a reasonable estimate for contract administration costs is between 10 and 20 percent of contractor costs. A general rule of thumb in applying this cost range would be to move toward the higher end of the range for small dollar contracts and the low end of the range for large dollar contracts. In instances where existing staff are assigned contract monitoring responsibilities, the low end of the range should probably be used.

An alternative approach to computing the cost of contract administration is to utilize the staffing formula developed by the Federal OMB. The OMB staffing formula is derived from a major study of federal contracting out conducted by a private accounting firm. It assumes that the best indicator of contract administration requirements is the number of people engaged in providing a service -- the larger the staff working on a particular service, the greater the contract administration requirements. For example, if it would take between 43 and 65 government staff workers to perform a given service in-house, the OMB formula indicates that the effort of three full-time-equivalent employees would be needed to conduct contract administration duties.

Because of the complexity of federal contract procurement laws and regulations, however, the OMB staffing formula may overestimate the actual cost of contract administration for some state and local governments. The Texas State Auditor's Office, for one, has revised the OMB staffing formula for purposes of computing the costs of Texas state agency contract administration.

*One-time conversion costs* are sometimes incurred in transferring a target service from in-house delivery to contract service delivery. Examples of one-time conversion costs include: 1) personnel related costs; 2) material related costs; and 3) other costs. When substantial one-time conversion costs are involved, these costs should be amortized over multiple years. The "front-end loading" of substantial one-time conversion costs into one year can skew cost comparisons between in-house and contract service delivery in favor of the former. If such costs are amortized, the cost of interest should be included in calculating the fully allocated costs of the expense which is amortized.

Personnel-related costs include unemployment compensation, accrued annual and sick-leave benefits, and other severance items that must be paid to terminated government employees.

Material-related costs include costs associated with the preparation and transfer of government property or equipment to be made available to a contractor for use in providing a target service. Other costs include any other one-time conversion costs, such as penalty fees associated with terminating leases or rental agreements, the costs of unused or under used facilities and equipment until other uses are found or they are sold, and other costs associated with the transition.

A related factor to consider is the possible need for *reconversion* if a decision to contract out proves to be disadvantageous. The ease with which government can once again begin performing a given service that was contracted out should be taken into account before that service is ini-

The subject of *performance measurement* also conforms to this rationale. Objective measurements of the quality of services performed would be a potent evaluation tool in the PERM process and beyond. The Kansas legislative and executive branches have already embarked on the path of its implementation. Again, the more pervasive adoption of such measurements would be exceptionally useful, but not imperative to the Council's goal.

### **Conclusion**

In sum, Kansas state government now has adequate capability to perform the cost accounting exercise necessary for fair and reliable PERM analyses. Comprehensive and expensive reforms are not needed if the objective is a case-by-case investigation of privatization candidates or other efficiency-enhancing ideas of a limited scope. Incremental yet significant progress is possible with the current level of accounting sophistication, if smaller, more manageable, PERM projects are undertaken in a pragmatic fashion. A major overhaul of accounting practices and computerization should be considered only if the goal is to implement a systematic process for reviewing every function, program and service of state government.

tially privatized. This concern emphasizes the need to assess and assure the reliability of private sector vendors as well as the need to perform an accurate cost analysis before privatization is undertaken. While contracting out is theoretically justifiable on the basis of any cost savings, many government agencies have adopted the policy that the cost savings should be sufficient to warrant the organizational upheaval associated with the changeover.

An *off-setting revenue* is any new or enhanced revenue stream (e.g., state or local income, sales, property or other taxes, user fees, etc.) that will accrue to the government as a result of contracting out a target service. If a revenue stream is already being received by a government and no revenue increase is anticipated, no entry is required. An item here that is sometimes overlooked is revenue to be derived from the sale or other disposition of facilities or equipment made redundant as a result of contracting out a target service. Any amount included in this section represents a *deduction* from the cost of contract service delivery.

When contractor costs, contract administration costs, and one-time conversion costs are combined and reduced by any off-setting revenues, the resulting dollar amount represents the total cost of contract service delivery.

### **Incorporating Accounting Reforms into a Broad Objective**

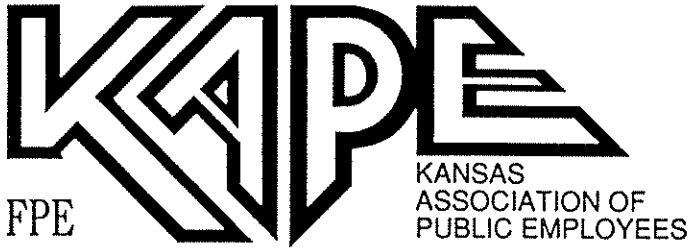
What is the broad objective? As discussed in the introductory section of this chapter, the dominant theme emerging from the Council is an interest in improving state government efficiency. The accounting of total costs is an essential analytical step in identifying and weighing privatization options and other possible outcomes of the PERM process. Before any responsible decision can be made to privatize, eliminate, retain or modify a given state function, we must know the function's true full cost as well as the true full cost of alternatives.

The other advantages of total cost accounting must also receive due consideration. It provides a much more complete disclosure of actual costs to those taxpayers concerned about how their money is being spent. It may also reveal compensable indirect cost allocations that lead to more federal participation money for state operations. These advantages, together with benefits derived through implementing PERM recommendations, would contribute to an improvement in efficiency that addresses the Council's objective.

What should be the scope of cost accounting reforms? Kansas could require all its agencies to develop cost allocation plans, or CAPs, without regard to whether these agencies receive federal money. Kansas could implement a uniform STARS coding system of the detail utilized in Texas. Both ideas have merit; in fact, the latter is basically a computerized version of the former. However, both ideas would be expensive to implement and neither is essential for significant efficiency gains.

CAPs are already used by many Kansas agencies. Those which do not employ them may consider their development to be cost prohibitive, may operate with a budget not large enough to warrant a CAP, or for other reasons might conclude that a CAP is neither useful nor necessary. If an agency has developed a CAP, PERM analysis of one of its functions would be simplified. If an agency does not have a CAP, the scope of the function being analyzed would probably be sufficiently small for its cost data to be compiled on an *ad hoc* basis.

The implications of an enhanced STARS network would be similar. While uniform coding would simplify PERM analyses, the absence of such coding does not preclude compilation of necessary cost data -- particularly when one considers the significant current use of index coding. The lack of uniformity will require additional PERM-process time devoted to translation of coding schemes, but that has not been an insurmountable problem in the Michigan experience.



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KANSAS COUNCIL ON PRIVATIZATION  
S.C.R. 1626

Privatization Alternatives and Concerns

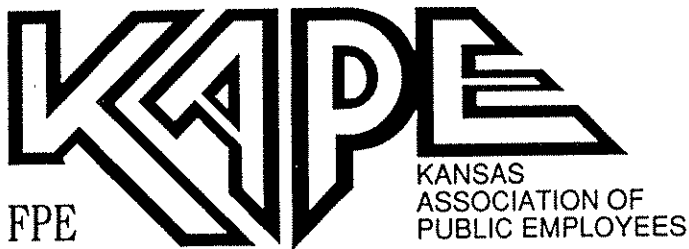
I. Concerns

As the Privatization Council summarizes it's recommendations, and as a member of that council and a representative of public employees, I feel that there are major issues and recommendations that I would like to submit in addition to those addressed by the council. The work of this council has focused on privatizing government services. High performance workplaces have found other options that produce quality services, efficient use of public resources and create highly motivated employees. These best practices have been recognized by the Office of the American Workplace and the U.S. Department of Labor. All of the various successful options were impossible to cover in just six months of study. If, in fact, the proposed PERM analysis is adopted, there remains other options of "retain" and "modify" that need positive, high performance modification. Employees and their labor unions in Kansas see this as an opportunity to forever change the systems they use to serve the people of Kansas and keep this state fiscally responsible. The options for employees, managers and taxpayers to join together for quality Kansas government need to be considered. There are other opinions that will be mentioned and appreciation is expressed to the Privatization Council for being a leader in including Kansas employees in their deliberations. We view this as a beginning and ask for the opportunity to participate in the future in designing a system that truly works.

II. Other Options

The contracting out of public services, in some cases, may save tax dollars if the contractor performs well and contracts are effectively and clearly written for proper objectives. However, the risk of poorly written contracts, loosely monitored activities, and political favoritisms with financial benefits may result in a much higher cost to the taxpayer. Lowering employees standards of living for the sake of profit may also shift costs from private contractors to the taxpayer in the long run.





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The PERM analysis is agreeable and may prove to be a valuable tool for the legislature, taxpayers, agencies and employees if it is bipartisan and administered honestly. It does not address the other options of "Retain" and "Modify".

Another option to include for "Retaining" and "Modifying" is a Labor-Management Partnership such as used by the state of New York. The goals and commitments contained in New York's plan, for example, are consistent with the employee's vision for Kansas government and quoted as follows:

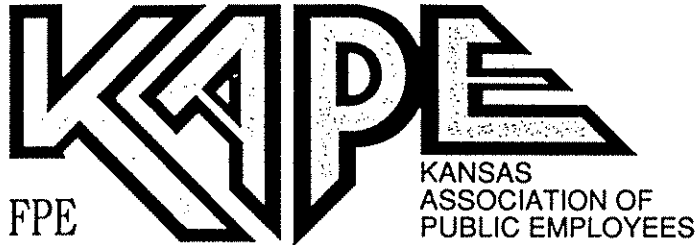
**Enhanced customer focus** -- Understanding that users of government services (including both direct and indirect users) are the final judges of quality. Developing constant sensitivity to the needs of an organization's customers (both internal and external) and committing to meet those needs expeditiously. Striving to ensure that program functions and attributes contribute value, lead to satisfaction, and affect preferences of customers.

**Best process** -- Recognizing that every work activity is a process to be improved or, if necessary, redesigned to obtain better results and enhance value to the customer. Eliminating unnecessary components, steps, delays, and errors. Improving responsiveness and cycle time. Coordinating interdependent or related processes across programs and agencies to guarantee the most effective use of resources.

**Empowered employees** -- Bringing the work force into the decision making process. Respecting people and their ability to contribute to improvement. Recognizing untapped potential in employees and encouraging innovation and entrepreneurialism among the work force.

**Continuous improvement** -- Improving products, services, and processes constantly. On a repeating basis, assessing progress quantitatively and qualitatively and using information gained to plan improvements. Never allowing the status quo to suffice.





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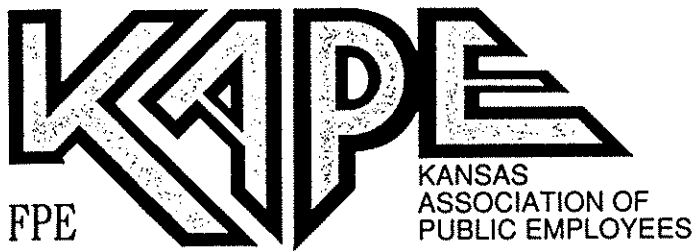
Fundamental to the success of this program is partnership between labor and management at all levels. KQM (Kansas Quality Management), which is similar, and is relatively new, needs expanded involvement and commitment, in which, employees are eager to participate. KAPE and their leadership will commit their resources and involvement in educating and encouraging employees to become committed to the above goals and to promote those goals to other unions and public employees.

A plan such as New York's could lead to new respect, ideas and services to make a win-win situation for all of Kansas. In the present recommendation, employee participation and commitment are missing.

### III. Criticism

The employees union, KAPE, was allowed a voice on this council and that is gratefully acknowledged. However, a true partnership, to address more than privatizing services, was never achieved. A responsibility to sincerely find the best methods available for quality government is not one to take lightly and I propose that further positive and cooperative efforts could lead to the high quality workplace desired. If the goal is just to privatize, without further employee involvement for redesigning the delivery systems, then it is probable we will never find a common ground. The focus should be on positive aspects of using employees, their experience and knowledge, to accomplish common goals in lieu of threats of job loss to privatization. Fear has been recognized as a detriment to high performance workplaces and there is constant fear in privatization. Further contracting out bureaucracy will be expensive, difficult to manage and control, and true accountability for quality services becomes lost in the shuffle. Employees are already turning to the union with complaints of declining services due to contracting out, training needs, understaffing, wasteful practices, needed equipment to perform their jobs, etc. The negative public employee image must change and we believe the employees of this state want to be a part of that change. Kansas legislators control agency budgets, appoint managers, and approve FTE positions. This state is our business and like a private business, it should be run with pride. Pride in management ability, quality services and in the employees who make it possible. Constant negative criticism of employees who must perform daily public services should not be encouraged or tolerated.





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The Office of the American Workplace was created in 1993 to examine and report on the very best practices employed by the country's best run workplaces. CEO's, managers, directors, labor leaders and workers, academic and investment leaders, came forward with "best practices" that further strengthen KAPE's position on high-performance, high-commitment enterprises.

Taken from the U.S. Department of Labor's November issue of "American Workplace," those practices were:

- # Training and continuous learning for every employee. High-performance organizations may devote 5 percent or more of payroll to training and will often cross-train employees in multiple skills. Today's workers need to master a broad array of new skills and find ways to constantly improve design and quality of products and services.
- # High-performance enterprises communicate strategic plans, management priorities, and financial and operating constraints as part of a systematic information sharing program.
- # Employee participation is built into the organizational structure and pushes responsibility down to teams of workers.
- # Organizational structures are flatter, broadening a worker's ability to respond to changing demands and creating flexibility within the enterprise. Products or services are no longer "handed off" to the next in line; entire teams invent new processes and build new services.
- # Increased flexibility leads to better worker-manager and labor-management partnerships, laying the foundation for a joint focus on product and service quality and on joint accountability, responsibility and decision making.
- # Compensation is linked to performance through such programs as gainsharing, profit sharing, employee stock ownership, and team-based pay.







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- # Layoffs become the option of last resort, since companies value their investment in workers. A number of companies cited a commitment to employment security by adopting no-layoff policies, redeploying workers, or using other strategies.
- # High-performance enterprises provide a supportive work environment, offering flexible work schedules, child care resources, health benefits, and other employee-friendly commitments.
- # And finally, high-performance firms and organizations view integration of these practices as essential to long-term, strategic business success.

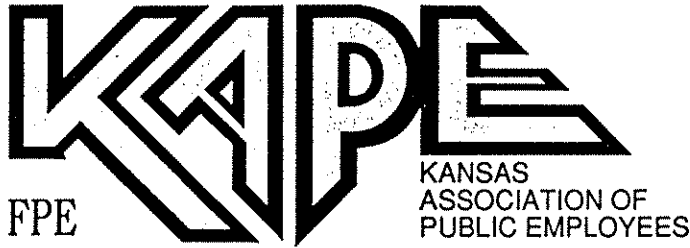
"The preliminary anecdotal and empirical evidence suggests a strong relationship between these practices and corporate performance," said Jonathan Low, director of OAW's Performance Measurement Project. "Not everybody is adopting high-performance practices yet. Our job is to build on the current information and share the results." He added that the next step would be "to encourage more businesses to adopt these practices, which, we believe, will make them more globally competitive."

The opportunity exists for this council to create a new program, taking advantage of the latest recommendations, and modeling their business of state services after those of the most successful businesses in the country. Considering the council's proposals, very few of the "best practice" principles outlined previously are included.

The contracting out of public services requires a very comprehensive monitoring process to safeguard public funds, assure contract compliance, monitor contractor quality and protect against any political improprieties.

The success of privatization and true cost reductions in agency budgets will depend on this carefully structured process. The accountability and monitoring processes have not been developed.





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While some degree of privatization exists in nearly every agency, KAPE is particularly concerned that agencies such as SRS and DOT, which are the most highly privatized, also account for a tremendous share of the state budget.

It is entirely possible, especially in light of the lack of a well founded procedure on which privatization decisions are based, that privatization is less efficient than programs delivered by public employees.

That possibility mandates the need for great caution in adopting privatization as a solution to the state's financial concerns. The privatization solution may be worse than the fiscal problem we are trying to address.

Another privatization concern for Kansas taxpayers should be the threat of fraud such as experienced recently by KPERS (Kansas Public Employees Retirement System) which is currently 84% privatized.

All contracting of services should be subject to open meetings laws and Freedom of Information Act for public protection and assurance of proper conduct.

#### IV. Recommendations

There are six items which any proposed plan should contain and guarantee:

1. The plan should demonstrate real cost savings.
2. Services should be equal to or better than currently provided.





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3. Potential contractors should avoid exploitation of employees by paying equitable wages with benefits and pensions and comply with equal opportunity and reporting requirements. (A study by Marshall Barry, PhD. at the Florida International University in Miami, showed that workers displaced by contracting out lost medical insurance for themselves and their family members. And employees of the contractor also had no health insurance provided by the contractor. As a result, many of these employees or their family members sought treatment at local public hospitals, with taxpayers footing the bill. In essence, the Florida taxpayers were subsidizing the private contractor's health insurance provision.)
4. Require open bidding, including employees and unions as bidders.
5. There needs to be an independent system monitor.
6. There must be an efficient cost accounting system in place to evaluate agency functions. True costs and current staffing levels must be known before proper comparisons can be made. Additionally, the costs of resuming government services must be considered in case of program failure.

Other cost accounting concerns to be considered include:

- o When analyzing in-house cost information for labor costs, the number of positions shown should reflect current staffing levels. Vacant or frozen budgeted slots should not be included in the cost estimate.
- o If materials and supplies are not provided to the contractor, then it's important to make sure that projected costs for these items do not outpace inflation.
- o In-house estimates for overhead should include only those costs which would disappear if work is contracted.





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- o In-house costs may also be higher than they should be because of bloated management, inefficiencies in service delivery, lack of investment in current employees or equipment or other reasons for high public cost.
- o Public budget cost that will continue with the contractor should be part of both in-house and contractor estimates of performing the work. Check that both parties agree on who bears the cost of particular items.
- o The agency may require contractors to provide for emergencies and insure against failure to provide services. Is the contractor bonded? Who is liable for poor performance or failing to provide a service? The public entity should be protected from lawsuits arising because of contracting failure.
- o Is the contractor being asked to do the same work and being held to the same standards as public employees? Often the contract itself may allow cuts in the quality, quantity or scope of service.
- o Are there cost considerations for services now provided by public employees for items such as Radiological Monitoring for Wolf Creek and Emergency Response Teams for radiation spills or accidents? Will contractors be expected to provide these services at no extra cost as KDOT does now? Will these services be cut? Will inspectors/monitors be required to attend training courses and who pays for necessary training? Other KDOT schools might include: Asphalt or Concrete Seminars; Pavement Marking; Bridge Inspection, etc.





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- o Reconversion costs need to be spelled out for clear understanding.

Personnel Concerns:

- o What investments are being made in current employees for training? How does it compare to other businesses? Are new skills rewarded or recognized? Are skills and training keeping up with technology or are various jobs allowed to become ineffective and inefficient to make contracting out more attractive?
- o As trained public employees retire, quit or otherwise leave public service, will there be private monitors monitoring other private contractors? Would that be good public policy?

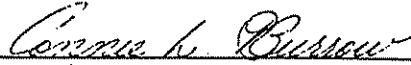
V. Conclusion

Public employees have chosen careers to serve the people of Kansas. Their dedication and time devoted to that service should not be jeopardized due to unsatisfactory systems that need revision. These employees should be a valuable resource to use in designing quality, effective workplaces.

Further cooperative efforts to solve existing differences and devise a higher level of quality government services is recommended. A truly competitive workplace is possible with cooperation. This council's recommendation is structured toward privatizing only.

To restore public faith and confidence in Kansas Government, there desperately needs to be a commitment from employees, unions, administrators, private industry and the Kansas legislature. A commitment to a higher level of state services and employment practices with regard to sound financial budgeting is recommended.

Respectfully Submitted by:

  
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Connie L. Burrow  
S.E. Vice President  
K.A.P.E.



1. The first part of the document discusses the importance of maintaining accurate records of all transactions. This is essential for ensuring the integrity of the financial data and for providing a clear audit trail.

2. The second part of the document outlines the various methods used to collect and analyze data. These methods include direct observation, interviews, and the use of specialized software tools.

3. The third part of the document describes the results of the data collection and analysis. It shows that there are significant differences in the way that different groups of people interact with the system.

4. The fourth part of the document discusses the implications of these findings for the design and implementation of the system. It suggests that the system should be designed to be more user-friendly and to provide more support for the different groups of users.

5. The fifth part of the document concludes the report and provides a summary of the key findings and recommendations.

6. The sixth part of the document provides a list of references and sources used in the report.

7. The seventh part of the document provides a list of appendices and additional information.

8. The eighth part of the document provides a list of figures and tables.

9. The ninth part of the document provides a list of footnotes and additional information.

## Appendix 3

### STATE AGENCY SURVEY ON PRIVATIZATION

1 What services do you currently contract out to the private sector?

Responses:	Agency:
none	State Board of Mortuary Arts
none	Legislative Research
financial audits office space	Legislative Division of Post Audit
Impaired Practitioner Program computer services legal services	Kansas Dental Board
legal services education trash service medical care dental care office machine maintenance chaplancy services optometric services	Kansas State Department of Credit Unions Youth Center at Beloit
none	Abstractors Board of Examiners
data assistance (consulting)	Division of the Budget
grain collection	Kansas State Grain Inspection Department
none	Ombudsman for Corrections
Licensure Examinations	Kansas Real Estate Commission
legal services consulting services computer programming office machine maintenance building security janitorial services	State Board of Education
court reporting services	Board of Tax Appeals
janitorial services pest control trash service Impaired Provider Program legal services consulting services press services court reporting services	Kansas Board of Healing Arts
consulting services	Citizens' Utility Ratepayer Board
consulting/engineering services pollution control with land owners	State Conservation Commission
consulting services consulting services/CPA computer support	Kansas Development Finance Authority
educational programs legal services computer support	Consumer Credit Commissioner
education services health care dental care mental health care chaplancy services	Parsons State Hospital & Training Center
lottery machine vendor	Kansas Lottery
educational services medical services dental services barber services telephone maintenance laundry service building maintenance pest control trash service	Youth Center at Atchison

1 Responses	Agency
medical services educational services natural gas fuel office machine maintenance	Larned State Hospital
computer assistance appraisals labor intensive road improvements consulting services (design, inspection) facilities maintenance	Kansas Department of Transportation
building maintenance computer assistance office machine maintenance educational services trash service laundry service pest control consulting services (mental health) consulting services (medical services) lab services pharmacist services vehicle insurance consulting services (management)	Rainbow Mental Health Facility
pest control building/facilities maintenance lawn care snow removal	Adjutant General's Department
consulting/engineering services computer services lab services waste tire remediation consulting services (health care)	Kansas Department of Health & Environment
food service book store consulting/engineering services computer assistance pest control vending machines trash service asbestos removal financial aid verification	Fort Hays State University
plumbing service electrical service decorations advertising carnival contract janitorial services printing entertainment grandstand support bus service porta-johns trash service	Kansas State Fair
educational services lab services medical services building maintenance/operation	Winfield State Hospital & Training Center
legal services office facility office maintenance communications services education services	Securities Commissioner



1 Responses	Agency
market inspection backtagging market testing fee based testing market brand inspection co. option brand inspection	Kansas Animal Health Department
student loan billing fire protection laundry services repair/maintenance - equipment repair/maintenance - computers consultants consulting/architects lab services	Kansas State University
consultants/medical exams/certification	Board of Emergency Medical Service
none	Kansas Sentencing Commission/Criminal Justi
consulting/investment services consulting/insurance administration computer support legal services	Kansas Public Employees Retirement System
office space exams/certification	Board of Cosmetology
computer maintenance bottled water	Revisor of Statutes
janitorial services snow removal office equipment maintenance auditing services medical peer review services legal services pest control elevator maintenance JTPA Program payment services trash service security service HVAC system maintenance	Kansas Department of Human Resources
postage phone service freight printing advertising office equipment repair/maintenance building repair/maintenance consulting/architects consulting/engineers utilities insurance pest control trash service legal services educational services entertainment food service	Pittsburg State University
office rent office machine rent/maintenance janitorial service lawn care snow removal educational services	Kansas Wheat Commission
legal services publishing	Kansas Judicial Center

1 Responses	Agency
medical care mental health care substance abuse treatment sex offender treatment halfway house services inmate visitors' centers chaplaincy services substance abuse testing educational services telephone service lab services consulting/architects major construction projects pest control janitorial services inmate funeral expenses	Kansas Department of Corrections
delivery service printing court reporting legal services exam materials & grading	Board of Technical Professions
consulting/engineering	Kansas Water Office
building maintenance	Kansas Bureau of Investigation
building security	Kansas State Historical Society
lawn maintenance	
duplication	Secretary of State
computer maintenance	
consulting/computer assistance	
none with State money	State Library
legal services	State Board of Indigents' Defense Services
professional consulting services	Kansas Corporation Commission
office rent	
computer services/maintenance	
physical testing of new employees	Kansas Highway Patrol
psychological testing of new employees	
dry cleaning	
building maintenance	
lawn care	
food service	
computer assistance	Department of Social & Rehabilitation Servic
alcohol & drug treatment	
mental health & retardation services	
Medicaid Information System	
food stamp distribution	
USDA food surplus storage	
managed care	
research & evaluation projects	
residential health care & services	
foster care	
employment services	
legal services	
security	
building maintenance	
child care	
building equipment & leases	
none	Board of Hearing Aid Examiners
food service	Emporia State University
bookstore	

1 Responses	Agency
printing computer support legal services office lease Industrial Development & Marketing aircraft chartering direct mail credit reporting advertising & promotion educational training international trade representation architectural consulting marketing consultants telecommunications janitorial services transportation/tours photography services	Department of Commerce & Housing
vehicle repair computer programming microfiche production permit sales consulting/engineering consulting/architectural inspections land surveys construction marina services agricultural leases trash collection specialized training mineral extraction fish identification specialized research legal services marketing services office space	Department of Wildlife & Parks
none	Department of Civil Air Patrol
staff training medical services educational services pest control trash collection natural gas fuel	Kansas Neurological Institute
CPA	Kansas Board of Accountancy
technology needs investigating services	Judicial Branch
advertising & marketing transportation services consulting architecture consulting engineering asbestos removal building maintenance computer services banking publishing & printing trash service hazardous waste removal collection service pest control laundry service health services educational services uniform rental service mailing service CPA snow removal sculpture restoration security telephone maintenance vehicle maintenance	Wichita State University

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**Responses**

**Agency**

banking services legal services auditors consultants computer support office machine maintenance	State Treasurer
Ambulance services anestehsia dental services medical/health care services specialized automotive work vehicle towing pager service cable TV trash service matal fabrication natural gas fuel utilities Medicare cost report preparation building maintenance package delivery grounds maintenance TQM training/consulting language/sign interpretation chaplaine services JCAHO survey mental health services computer education criminal record checks drug testing office machine leasing rest control office machine maintenance cellular phone educational services	Topeka State Hospital
office machine maintenance microfilming of records	State Banking Commissioner

**FINAL REPORT**

**Kansas Council on Privatization**

**PRIVATIZE, ELIMINATE, RETAIN OR MODIFY:  
A STRATEGY FOR COMPETITIVENESS IN GOVERNMENT**

**January 20, 1995**

*Submitted to*

*Governor Bill Graves*

*Senate President Paul Burke*

*House Speaker Tim Shallenburger*

*Selected sections  
attached. Contact  
HQ or KS for  
more info —  
SD*



Senate Concurrent Resolution No. 1626

A CONCURRENT RESOLUTION creating the Council on Privatization; designating its membership, authority and responsibilities; and requiring a report to the 1995 Kansas Legislature on its findings and recommendations.

WHEREAS, The private sector should be encouraged to provide goods and services, traditionally provided by state government, when they can do so at a comparable quality and lower cost; and

WHEREAS, The use of private contracts can potentially save tax dollars and improve the efficiency and effectiveness of services to the public; and

WHEREAS, The State of Kansas and many other states, as well as the federal government, have undertaken initiatives with the goal of "reinventing government" and increasing the privatization of public services; and

WHEREAS, The Governor and the Legislature are in need of specific recommendations that will increase the efficiency and effectiveness of state government, strengthen the role of the private sector, and lead to cost savings and reduce the tax burden of Kansas citizens: Now, therefore,

*Be it resolved by the Senate of the State of Kansas, the House of Representatives concurring therein:* That there hereby is appointed the Kansas Council on Privatization; and

*Be it further resolved:* That the council shall consist of 15 members chosen in the following manner:

(a) The President of the Senate, the Minority Leader of the Senate, the Speaker of the House of Representatives and the Minority Leader of the House of Representatives shall each appoint one member of the Kansas Legislature;

(b) the Governor shall appoint a member of the Governor's cabinet;

(c) the legislative coordinating council shall appoint jointly six members as follows:

(1) A member of the Kansas Chamber of Commerce and Industry;

(2) a person who has been distinguished as a leader of the business community in Kansas and represents small business;

(3) a representative of a Kansas taxpayers' association or organization;

(4) a certified public accountant with experience in governmental auditing, accounting and budgeting;

(5) an attorney who is a member of the Kansas Bar Association; and

(6) a member of a state public employees' union;

(d) the Board of Directors of Kansas, Inc. shall appoint a private sector member of the board;

(e) the Kansas Board of Regents shall appoint a faculty member of a Kansas regents university with experience in state government and a record of research in public administration;

(f) the league of Kansas municipalities shall appoint a local government official; and

(g) the Kansas association of counties shall appoint a local government official.

The chairperson of the council shall be a private sector member elected from among the members of the council; and

*Be it further resolved:* That the council shall have the following responsibilities:

(a) Identify and study state governmental activities that may be in competition with the private sector;

(b) study the desirability and feasibility of contracting for private sector performance of governmental services;

(c) identify methods by which members of the public and private sectors can work together to accomplish desirable public policy objectives;

(d) identify barriers to making public sector operations more competitive;

- (e) recommend administrative changes and prepare legislation that will eliminate barriers to privatization and modify state statutes and regulations that impede the private contracting of public services;
- (f) study the possible impact of privatization on state employees;
- (g) prepare legislation to establish an on-going process and entity that will ensure maximum use of privatization and private contracting by Kansas state government, including, but not limited to, a private enterprise review board that can receive petitions of interest from private business desiring to provide a public service, and petitions from the private sector alleging competition from the public sector; and
- (h) provide the citizens of Kansas and members of the private sector an opportunity to give comments on these subjects through the conduct of public hearings; and

*Be it further resolved:* That the Council on Privatization shall be made a part of Kansas, Inc. Subject to appropriations acts relating thereto, Kansas, Inc. shall provide staff support to the council. Members of the council shall receive per diem and travel reimbursement for their attendance at meetings of the council or its committees. In addition, Kansas, Inc. shall provide private sector funds to support the council; and

*Be it further resolved:* That agencies of state government shall cooperate fully with the council and its staff in the provision of information and data as may be requested and required to accomplish its responsibilities. The council may call upon the Secretary of Administration and the Director of Legislative Research to provide staff support and assistance; and

*Be it further resolved:* That the council shall issue a final, written report to the Governor, President of the Senate and the Speaker of the House by January 20, 1995. The chairperson and members of the council shall testify before the Kansas Legislature on their findings and recommendations during the 1995 Legislature. The council shall be abolished on June 30, 1995.

I hereby certify that the above CONCURRENT RESOLUTION originated in the SENATE, and was adopted by that body

March 2, 1994

SENATE adopted  
Conference Committee Report April 7, 1994

Pat Sawille  
President of the Senate.  
Secretary of the Senate.

Adopted by the HOUSE  
as amended March 24, 1994

HOUSE adopted  
Conference Committee Report April 7, 1994

Just E. Jones  
Speaker of the House.  
Chief Clerk of the House.



KS

Appendix 5  
State Agency Survey on Privatization

possible candidates for privatization

printing  
laundry  
custodial services  
food services  
motor pool  
mail  
security  
correctional industries  
industries for the blind  
printer, paint, cleaning supplies, signs  
paint  
Information services  
computing services  
personnel services  
architectural services  
educational services  
training services  
"...any program offered by government..."  
legal services  
road construction & maintenance  
veterinarian services  
Travel Information Centers  
fish production  
hunting  
fishing  
community level residential care  
Kansas Development Finance Authority,  
forensic lab services  
Production of Annual Report  
eye care for youth  
rest area maintenance  
gift shop  
ticket sellers-takers  
special purpose audits  
exam administration  
new services on INK  
water/waste water inspections  
permit reviews  
public service announcements  
cost/benefit analysis in conjunction w/ new reg's  
collection services  
pharmaceuticals  
receipts depositing  
medical services

