

AGENDA

ASSEMBLY BUDGET SUBCOMMITTEE NO. 4 On State Administration

Assemblymember Tom Ammiano, Chair

**TUESDAY, JUNE 30, 2009, 10:00 AM
STATE CAPITOL, ROOM 444**

OUTSOURCING OF STATE CONTRACTS

- 1) STATE EMPLOYEES INTERNATIONAL UNION (SEIU) 1000 AND PROFESSIONAL ENGINEERS IN CALIFORNIA GOVERNMENT (PECG)
- 2) DEPARTMENT OF FINANCE
- 3) OFFICE OF THE CHIEF INFORMATION OFFICER
- 4) MEMBER COMMENTS AND QUESTIONS

Background

Services provided by state agencies generally must be performed by state civil service employees. The civil service system includes every officer and employee of the State with few exceptions.

The constitution does not prohibit outsourcing of state work through contracts, but courts have held that there are certain restrictions on the practice. Further, statute provides that any proposal to contract out state work must demonstrate:

- Contracts result in cost savings to the state.
- Contractor's wages may not significantly under-cut state pay rates.
- Contracts cannot displace civil service employees.

There is often controversy surrounding the practice of outsourcing contracts for state work. Debates center on costs and savings, as well as a question of transparency of these contracts.

In 2004-05, the Governor proposed a constitutional amendment to expand the circumstances in which the state could contract with private entities. In their analysis of the budget and that proposal, the Legislative Analysts Office (LAO) pointed out that, "evidence suggests that carefully managed privatization can, under the right circumstances, provide specialized expertise, save money, and/or result in improved service delivery. It also, shows, however, that poorly managed privatization under the wrong circumstances, can lose money and result in poor service delivery."

The LAO recommends the Legislature may wish to consider the following in considering the role of contracting in state work:

- ◆ Accountability. How can government ensure that it retains an appropriate degree of oversight and responsibility for provision of a service being outsourced?
- ◆ Accurate Cost Comparisons. Government needs to ensure that it accurately projects the savings from outsourcing. This requires accurate cost comparisons between providing a given service directly by the government and by the private sector.
- ◆ Realization of Net Benefits. What steps are needed to ensure that the potential benefits of outsourcing are captured for taxpayers? For example, how can government make sure that potential benefits to taxpayers are not shifted to contractors through increased profit margins and overcharging?
- ◆ Quality Control. What steps can be taken to make sure that the desired quality of outsourced services is provided and maintained?

- ◆ Service Disruptions. How can governments protect against untimely disruptions in the provision of needed public services by private entities with whom they contract, either due to lack of adequate performance or withdrawal from service?
- ◆ Dismantling of Public Institutions and Skills. If outsourcing shifts the provision of governmental services from existing public institutions and governmental workforce to private parties, what are the short-term and long-term implications of dismantling these institutions and losing these public labor skills, in the event that privatization turns out to be less desirable than initially hoped for?

Overview of Current State Outsourcing:

A recently published report by SEIU 1000, looks at the issue of contracting out of state work across a wide spectrum of state departments. Their report raises issues about potential savings that may be achieved for the General Fund and special funds, as well as the extent to which information on the expenditure of taxpayer money in this regard is tracked and can be accessed by the public. Some of the key findings of their research are:

The value of 13,600 personal services and consultant contracts currently in effect is \$34.7 billion, a figure that includes spending for the current, prior and future fiscal years covered by ongoing contracts:

- ◆ 748 Architectural and Engineering contracts:.....\$2.4 Billion
- ◆ 2,345 IT contracts:.....\$4.1 Billion
- ◆ 10,507 Non-IT contracts:.....\$28.2 Billion

They estimate that the state could save approximately \$350 million annually by utilizing state workers to cut unnecessary and wasteful outsourcing in just these three areas alone:

- ◆ \$100 million or more annually in IT contracts
- ◆ \$144-\$205 million or more annually in medical registry contracts
- ◆ \$50 million or more annually in architectural and engineering contracts

The State of California tracks its contracting spending through its State Contract Procurement Registration System (SCPRS) operated by the Department of General Services (DGS). SEIU and others have suggested, however, that this system could use improvements, including adding information on cost overruns for these contracts as well as delays in implementation and product delivery.

AB 756 by Assemblymembers Eng and Lieu requires state agencies to annually prepare a report, available on each agency's Internet Web site, listing personal services and consulting services contracts entered into in the previous fiscal year (FY) and to

electronically submit that report to the Department of Finance (DOF) and the Legislature.

Governor's Executive Order S-09-09:

On June 8, 2009, Governor Schwarzenegger issued an Executive Order directing all departments under Executive Branch Authority to do the following in regard to outsourcing of state work:

- ◆ To disencumber any 2008-09 funding for contracts entered into on or after March 1, 2009, for goods and services that have not been provided, or for contracts proposed to be entered into during the 2008-09 fiscal year, regardless of fund source, and to revert those disencumbered funds to their original fund source, as long as no legal liability would be incurred. Exceptions are made for projects funded by the American Recovery and Reinvestment Act, or projects funded by bonds, grants or projects specifically mandated by court orders or public-private partnerships.
- ◆ To develop and submit a plan to their Agency Secretary that provides for a reduction of the department's appropriation to be encumbered by new contracts, extended contracts or purchases from statewide master contracts in the 2009-10 fiscal year by at least 15%.
- ◆ To not enter into any new contracts, amend any existing contracts, issue purchase orders for goods and services, or make purchases from statewide master agreements or leveraged procurement agreements, until such time as the department's contract reduction plan is approved.
- ◆ Additionally, the Governor issue Executive Order S-08-09 which requires starting June 19th, 2009, that all awarded contracts valued at \$5,000 or more be placed online within 5 days of signing.

These Executive Orders may help address the concerns raised regarding the amount of contracting done by the state, as well as the transparency of those contracts.

OCIO:

The legislature recently allowed the Governor's Reorganization Plan #1 to move forward, allowing the Office of the Chief Information Officer (OCIO) to greatly expand its responsibilities, and to consolidate several State IT functions under their authority.

Part of their new role will be to track, review, and oversee state IT contracts. As discussed above, there may be the potential for considerable savings in these efforts. The OCIO estimates that over the next 5 years they could save the state as much as \$38 million by better managing the need for these contracted services.

Questions

DOF:

- ◆ When determining whether to contract out a service, what kinds of comparisons are made between contractor costs and state pay rates for workers performing the same services?
- ◆ Has there been any effort to compare cost, quality of work, and timeliness of job completion between contracted work and state employees?
- ◆ How will EO S-09-09 be implemented? Do departments have reduction plans, approval plans prepared yet? Is there an estimated savings from the 15% required reductions in departments contracting costs?

OCIO:

- ◆ What efforts have you already undertaken to better understand the scope of contracts for IT throughout state government?
- ◆ What efforts do you plan to undertake to properly review the need for these contracts, and manage any changes needed in state policy regarding using such contracts?
- ◆ How can other aspects of state government follow the lead the OCIO has set for tracking and managing IT contracts?