

**STATE OF NEW HAMPSHIRE
STATE AGENCY DECISION-MAKING PRACTICES:
EMPLOYEES VERSUS CONTRACTORS**

**PERFORMANCE AUDIT REPORT
MARCH 2013**

To The Fiscal Committee Of The General Court:

We conducted a performance audit of State agency practices used to determine whether to contract-out or use State employees to provide services during State fiscal year 2012. The audit addresses a recommendation made to you by the joint Legislative Performance Audit and Oversight Committee. We conducted the audit in accordance with generally accepted government auditing standards. Those standards require we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions. The evidence we obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Office of Legislative Budget Assistant

Office Of Legislative Budget Assistant

March 2013

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**STATE OF NEW HAMPSHIRE
DECISION-MAKING: EMPLOYEES VERSUS CONTRACTORS**

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 ABBREVIATIONS	
DAS	Department Of Administrative Services
G&C	Governor And Council
LBA	Office Of Legislative Budget Assistant
LPAOC	Legislative Performance Audit And Oversight Committee
MoP	Manual Of Procedure
RSA	Revised Statutes Annotated
SFY	State Fiscal Year

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STATE OF NEW HAMPSHIRE
AGENCY DECISION-MAKING: EMPLOYEES VERSUS CONTRACTORS

EXECUTIVE SUMMARY

We were asked to examine if State agencies determined whether it was more cost-effective to hire personnel or contract for services during State fiscal year (SFY) 2012. The State agencies we examined usually did not determine whether it was more cost-effective to contract-out or provide a service in-house using existing or new State employees. Instead, agencies often reported their budgets set the number and type of employees available. This, in turn, drove contracting because remaining service needs could only be met with contractors. Some agencies did not analyze whether it would be more cost-effective to contract-out or perform a service in-house. When analysis was undertaken, agency decision-making was usually informal or ad hoc, and agencies inconsistently considered cost, effectiveness, and risk during these analyses. No statewide law, rule, or policy required agencies conduct comparative analyses. No oversight body consistently requested agencies to report on comparative analyses.

Some governments at the state, federal, and local levels regulate their agencies' decision-making processes when they choose between contracting-out or performing a service in-house with public employees. Efficiency and effectiveness were often the focus of these efforts. These processes often relied on structured competition to help produce cost savings and improve service quality, regardless of whether a public or a private entity was selected. Formal plans demonstrating the costs and benefits of proposed options were integral to these processes and helped ensure alternatives were considered uniformly and transparently. We compared State agency processes against these observed practices.

The 21 agencies we examined contractually obligated approximately \$3.5 billion in SFY 2012 through 986 multi-year service contracts. In SFY 2012, these agencies were budgeted for approximately \$754 million in personnel-related expenditures. The vast majority of these commitments were entered into without the benefit of a comparative analysis to determine which was in the State's best interest.

We recommend the Legislature consider defining inherently governmental functions and commercial services, and provide guidance on when agencies must: 1) provide a service using State employees, 2) provide a service using contractors, and 3) conduct analyses to determine which method is in the State's best interest. We also recommend the Legislature consider to what extent it may wish to structure State agency decision-making processes when agency managers are required to consider whether to contract-out or provide a service using State employees. The Legislature might simply require comparisons be completed, or provide more guidance, specifying how analyses are to be completed, what analyses must include, and what oversight of decisions is required. Changes to State budget law may provide a suitable means to provide this guidance, and there may also be a need to provide a way for agencies to submit changes resulting from comparative analysis to their budget outside the normal budget cycle.

This audit did not focus on individual contracts or contracting at any one agency. We requested a response to the audit from the Department of Administrative Services in its capacity as the conduit for service contracting in the Executive Branch.

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AGENCY DECISION-MAKING

Background

State agencies provide a wide variety of services directly using State employees and indirectly through contractors. Services can be internal to an agency (e.g., database administration or consulting) or external (e.g., provided to the public, such as road paving or search-and-rescue). No single source of data enumerates all State service contracts and contract expenditures. Based on our review of Governor and Council (G&C) minutes for SFY 2012, the 21 State agencies we selected for review entered into or modified 986 service contracts or similar agreements valued at over \$3.5 billion. The periods these contracts covered varied and we were unable to quantify each contract's value for SFY 2012 alone. The multi-year contract values we could identify ranged from \$2,525 (or less than one percent of the total value of contracts entered into during SFY 2012, for siding repair services) to over \$2.2 billion (or nearly 64 percent of the total value of contracts entered into during SFY 2012, for Medicaid managed care services). During SFY 2012, these same agencies were budgeted for over \$754 million in personnel-related costs.

Statutory, Regulatory, And Procedural Controls

No generally applicable law, rule, or policy exists mandating State agencies systematically conduct cost-benefit or similar analyses when deciding whether to provide a service by contracting-out or by using State employees. Agencies are not required to demonstrate which alternative is in the State's best interest, even though properly implemented comparative analyses can help: 1) structure and inform decision-making and 2) ensure efficient utilization of limited resources. Further, no law, rule, or policy establishes any service as inherently governmental (i.e., not subject to contracting-out), although some agencies are required by agency-specific or biennial budget laws to either contract-out for certain services or utilize State employees to directly provide other services. For example RSA 284:20-g, I, provides the Racing and Charitable Gaming Commission "shall contract with a qualified laboratory to provide laboratory testing services...", RSA 328-A:3, XI, states the Physical Therapy Governing Board "shall...[e]nter into contracts for services necessary for adequate enforcement of this chapter," and RSA 604-B:4 provides the State "shall contract with any organization or groups of lawyers approved by the board of governors of the New Hampshire Bar Association to operate the public defender program..." Such legislative mandates eliminate the need for agencies to consider cost-benefit analyses to determine whether employees or contractors are more cost-beneficial.

State "policy and objectives" include "[t]he organization of state government should assure efficient, effective and responsive administration of the policies established by the legislature" (RSA 21-G:3, III). Commissioners must adopt practices to improve efficiency (RSA 21-G:9, II(e)) and may contract-out services "[w]henever it shall be more cost effective and efficient" than using in-house staff (Chapter 469:61, Laws of 1983), providing broad permission to contract-out. Statute also provides permission to the Governor, G&C, or their Department of Administrative Services (DAS) designee to seek increased efficiency in State government (RSA 9:12). Nothing requires ongoing efficiency reviews, however.

Generally, agency authority to contract, enter into agreements, and otherwise engage entities to provide services is broadly distributed in State law. In only a few instances does State law provide agencies an ‘either-or’ option allowing them to select between contracting-out or using State employees to provide a service. For example, RSA 328-A:3, IV, states the Physical Therapy Governing Board “shall...[e]mploy or contract with any entity for the purpose of administering examinations authorized by this chapter,” and RSAs 135-C:3 and 126-A:5, II, provide the Department of Health and Human Services Commissioner may “directly operate and administer any program or facility” providing client services or may enter into a “contract...for the operation and administration of any such program or facility...” These options only provide *permission*. We only identified one statute requiring a decision be made in the best interest of the State, and that was only if keeping service provision in-house was in the State’s best interest (RSA 21-I:80, II). The few mandates which *require* State agencies to contract for services include specific services and types of services over set dollar thresholds. General oversight and approval of the “expenditure of any moneys” by agencies is vested in the G&C “under such general regulations as the governor and council may prescribe...for the purpose of securing the prudent and economical expenditures of the moneys appropriated.” (RSA 4:15) To effect control, the DAS publishes a Manual of Procedure (MoP) detailing G&C requirements applicable to most agencies.

Many agencies are required by statute to hire classified and unclassified State employees, such as commissioners and directors under RSA 21-G:8. Other statutes permit or require agencies to employ various staff to accomplish agency goals without mandating whether they be State employees (classified or unclassified) or contractors. G&C involvement is stipulated in statute in several instances and the MoP also establishes procedural controls over seeking new State employees, while DAS administrative rules regulate the classified personnel system.

Other Jurisdictions’ Practices

We reviewed the practices other governments at the state, federal, and local levels which regulated the decision to out-source a service or perform it in-house. Many did so with the goal of improving efficiency and effectiveness. Some jurisdictions established functions as inherently governmental or commercial (i.e., subject to a competitive sourcing process and contracting). This distinction established what services agencies cannot, may, or must contract out. Inherently governmental functions might include: 1) the exercise of discretion in applying authority or making value judgments; 2) binding a government to take or not take an action; and 3) significantly affecting the life, liberty, or property interests of private persons.

Policy established when and how agencies in other jurisdictions decided to use contractors or employees to provide services. Some jurisdictions found out-sourcing and personnel policies should be complementary. Contracting was only one method to improve efficiency; reengineering and streamlining were considered when the service was provided in-house or by contract. Competition between public and private entities was also considered and was found to underpin efficiency and continuous improvement. Some jurisdictions found competition could produce cost savings and improve service quality, regardless of whether a public or a private entity was selected. Decisions based only on cost did not necessarily deliver the best results, although cost was always a factor in decision-making.

Some jurisdictions required formal plans when agencies considered whether to contract-out or provide a service using employees. These plans demonstrated the costs and benefits of proposed options. Some jurisdictions set dollar thresholds below which analyses were not required to avoid expending time and effort on a process which could outweigh any potential savings. For services with a value exceeding the threshold, calculating the full cost of in-house and contracted services was necessary. Factors of full cost included all direct (e.g., salary, benefits, supplies, travel, and rent) and applicable indirect (e.g., overhead, contract administration, depreciation, and tax implications) costs, whether they were qualitative or quantitative. Benefits were also qualitative and quantitative, and included improved efficiency, effectiveness, timeliness, reliability, and security. Additionally, analyses considered risk, public and political sensitivity, and legal issues.

Formal processes helped ensure alternatives were considered; permitted external review of each course of action; informed decision-making; helped avoid poor decisions, incomplete planning, and bias; and avoided doing business intuitively. Formal processes also fostered comprehensiveness, transparency, and consistency within and among decisions. Such processes permitted a determination as to which course of action was in a jurisdiction's best interest. Some jurisdictions formed bodies to oversee and facilitate this analytical process, and required regular re-analysis of decisions. Some also included a training and education component in their system.

Prior Audits

Prior LBA performance audits examined contracting processes generally or contracting processes at specific agencies. In our 2009 *Service Contracting* performance audit report, we concluded State service contracting was decentralized and lacked oversight, standardization, and an overarching statute, thereby compromising management control, efficiency, and effectiveness. We recommended the establishment of a single procurement statute which would include a requirement that agencies justify contract need based on service type or contract value. While some legislative and agency-level changes have been made, contracting laws, rules, and policies have not fundamentally changed since 2009, and weaknesses remain.

Further, in 2009 we found:

- no statewide requirement for agencies to justify a service contract's need in writing or to conduct a cost-benefit analysis;
- practices for identifying contract need before starting the contracting process were inadequate;
- agency decisions could be based on agency best interest, not the best interest of the State;
- consistent, centralized guidance was lacking, as were templates and forms for agency use and training for agency staff; and
- written justification or cost-benefit analyses for specific procurements, such as privatizing State services or procurements above certain dollar thresholds, were needed.

We also found cost-benefit analyses and lifecycle cost analyses could assist agencies in determining whether a commercial procurement would be efficient and effective for service delivery. However, agency personnel involved in service contracting reported infrequently performing cost-benefit analysis and instead reported the decision to contract was based on the availability of in-house staff expertise.

Observation No. 1

Systematically Conduct Analyses To Decide When To Contract-out Or Use State Employees To Provide A Service

During SFY 2012, analyses were not systematically conducted when agencies decided to contract-out or use State employees to provide a service in-house. We asked 21 State agencies to describe the processes they used to decide whether to contract-out or perform a service in-house, using new or existing State employees. Nineteen agencies (90 percent) reported contracting for services, nine agencies (43 percent) reported conducting analyses which resulted in keeping some services in-house, and 12 agencies (57 percent) reported they considered moving 43 contracted services in-house. Fourteen of 19 (74 percent) reported doing formal or informal analysis to determine whether it would be better to contract-out or perform the service in-house, but inconsistently considered cost, effectiveness, and risk during these analyses. Five of 19 (26 percent) reported conducting no analysis. Only one agency documented its decision-making procedures, with a flowchart.

Although agencies lacked a formalized process, most were able to enumerate the factors they might consider during decision-making, which are summarized in Table 1.

Table 1

Agency-reported Factors Affecting Decision-making

Factor	Agencies	Percent¹
Resource availability	14	74
Cost	13	68
Expertise availability	11	58
Scope	11	58
Time	10	53
Other (e.g., funding source, perceived risk, quality)	10	53

Note ¹: Percentages are based on 19 agencies which provided responses.

Source: LBA analysis.

We asked 17 agencies about the decisions that led to 105 contracts we subjectively sampled and which were entered into or modified in SFY 2012. Of the 105 contracts, agencies reported considering using State employees prior to deciding to contract in 12 instances (11 percent) and using State employees was not an option due to external mandates in 27 instances (26 percent). In the remaining 66 instances (63 percent) using employees was reportedly not considered. No

agency provided documentation detailing the decision to either contract-out or provide the service in-house for these 105 contracts. However, five agencies did provide eight examples of written decision documentation for services outside the 105 contracts we asked about. Our review demonstrated these five agencies inconsistently considered factors we identified being commonly used by other states, municipalities, and the federal government. Some agencies considered some of the same factors, however, none of the agencies considered all the factors. Only one agency provided more than one example of a written cost-benefit analysis.

While nothing in law, rule, or policy prohibits agencies from undertaking deliberate cost-benefit analyses, either within or outside the budget process, many agencies reported being constrained by the budgets. Budgets established the number and expertise of personnel available, constituting a sunk cost to always be used first, and the amount available for contracts, which could be used to make up the difference between available staff capacity and actual service needs. They also noted approval authorities were at times reluctant to approve significant changes outside of the budget process. The statutory structure around the budget process supports the maintenance of the status quo through incremental budgeting, which inherently incorporates past budget decisions into future base assumptions. As a result of the processes in place, agencies reported analysis to determine whether in-house or contracted service provision was more cost-effective was deemed unnecessary. Overall, 17 agencies reported several factors which they believed obviated the need to conduct analysis, such as:

- lack of in-house expertise (16 agencies or 94 percent),
- agency budgets (12 agencies or 71 percent),
- lack of enough in-house staff (11 agencies or 65 percent),
- federal requirements (eight agencies or 47 percent),
- the proprietary nature of a service (three agencies or 18 percent),
- other State requirements (three agencies or 18 percent)
- elected officials influencing a course of action (three agencies or 18 percent),
- lack of specialized equipment (three agencies or 18 percent), and
- the service was typically provided by the private sector (two agencies or 12 percent).

Most agencies reported a belief that their practices were adequate to protect the State's interests. Agencies also stated oversight bodies, such as the G&C or legislative oversight committees, rarely if ever, required an analysis of whether a service should be provided by a contractor or by State employees prior to approval of a contract, new position, or reclassification. However, the lack of systematic controls or oversight over agencies' decisions to either provide a service using State employees or contract-out led to ad hoc decision-making disconnected from efficiency-related concepts in statute. This created the potential for inefficiency.

Recommendations:

We recommend the Legislature consider defining inherently governmental functions (those which must be performed by State employees) and commercial services (those suitable for private sector contracting) and consider providing guidance on when agencies must:

- **provide a service using State employees,**
- **provide a service using contractors, and**
- **conduct analyses to determine which method is in the State's best interest.**

We also recommend the Legislature consider to what extent it might wish to structure State agency decision-making processes when agency managers are required to consider whether to contract-out or provide a service using State employees. The Legislature might require comparisons be completed without detailing the methods by which comparisons are to be accomplished. Alternatively, the Legislature might provide guidance on how analyses are to be completed, what analyses must include, and what additional oversight of decisions may be required.

Further, the Legislature may wish to consider incorporating any requirements and guidelines into the budget statute and process. This may also require provisions to provide agencies flexibility to seek changes to their budget resulting from cost-benefit analyses conducted outside of the regular budget cycle.

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APPENDIX A
OBJECTIVES, SCOPE, AND METHODOLOGY

Objectives And Scope

In July 2012, the Fiscal Committee of the General Court adopted a joint Legislative Performance Audit and Oversight Committee (LPAOC) recommendation to conduct a performance audit of State Executive Branch agency decisions during State fiscal year (SFY) 2012 to hire personnel versus hire contractors to provide public services. We held an entrance conference with the Department of Administrative Services (DAS) in September 2012. The LPAOC approved the proposed scope statement at its October 2012 meeting, with the proviso some larger Department of Transportation contracts be included in our detailed analysis. This performance audit was designed to answer the question:

Did State agencies determine whether it was more cost-effective to hire personnel or contract for services during SFY 2012?

The audit focused on services involving the use of individual skills, regardless of whether the contracted entity was an individual, company, or corporation, such as physicians, plumbers, lawyers, electricians, consultants, and janitors. We also included Department of Transportation contracts such as highway maintenance and paving.

Methodology

To understand the practices State agencies utilized when deciding to contract for a service or provide the service in-house using employees, we:

- Selected 21 State agencies to examine, including the Banking Commission; New Hampshire Employment Security; the Adjutant General's Department; and the Departments of Administrative Services, State, Education, Cultural Resources, Resources and Economic Development, Environmental Services, Information Technology, Health and Human Services, Insurance, Transportation, Revenue Administration, Labor, Fish and Game, Safety, Corrections, Treasury, Justice, and Agriculture, Markets, and Food. While these agencies constitute the majority of State government, the sample was subjective. We excluded boards, councils, authorities, other quasi-governmental entities, and most commissions.
- Surveyed and received responses from each of the 21 selected State agencies using a Web-based tool with questions focused on general agency practices. The detailed survey results are contained in Appendix C.
- Requested 11 agencies complete an e-mail questionnaire focused on detailed agency practices. We requested agencies describe and document their decision-making related to a judgmental sample of contracts which went before the Governor and Council (G&C) during SFY 2012. We conducted follow-up via e-mail and telephone to clarify agency practices. We reviewed agency documentation and responses to our questionnaire.

- Conducted in-depth interviews with managers from six agencies which were the agencies most frequently before the G&C requesting contract approvals during SFY 2012. We requested agencies describe and document their decision-making related to a judgmental sample of contracts which went before the G&C during SFY 2012. We conducted follow-up via e-mail and telephone to clarify agency practices. We met with assistant commissioners, division directors, assistant directors, finance directors, chief financial officers, administrators, supervisors, engineers, architects, geologists, purchasing agents, and financial managers. We reviewed agency documentation and responses to our questions.

To understand the system within which agencies undertook decision-making, we:

- Reviewed SFY 2012 G&C meeting minutes for contracting events and requests for approval of new, or the extension of temporary, State employees.
- Reviewed over 140 applicable State laws, administrative rules, policies, and other regulations.
- Interviewed DAS officials and LBA Budget Division budget officers.
- Reviewed prior LBA audits with findings related to service contracting, obtained DAS management's assertions on the status of several prior observations, and obtained and reviewed documentation supporting the DAS's resolution of findings. The results of our review are contained in Appendix D.

To understand general practices governments in other jurisdictions follow when their agencies decide between contracting-out or providing a service in-house, we:

- Reviewed applicable laws, rules, policies, or practices of ten other states and two municipal governments, and the federal government. The jurisdictions were subjectively chosen for their utility in addressing our scope.
- Reviewed related research or analysis from government, academia, and public policy interest groups, including the National Council of State Legislatures, the U.S. Government Accountability Office, the federal Office of Management and Budget, the Council of State Governments, the National State Auditors' Association, and the Congressional Research Service.
- Requested other state audit agencies provide any reports available on their states' practices for deciding whether to contract-out a service or provide the service in-house, receiving and reviewing reports from two states.

The audit period was SFY 2012. We conducted the audit from September 2012 through January 2013 in accordance with generally accepted government auditing standards.

STATE OF NEW HAMPSHIRE
AGENCY DECISION-MAKING: EMPLOYEES VERSUS CONTRACTORS

APPENDIX B
DEPARTMENT OF ADMINISTRATIVE SERVICES RESPONSE TO AUDIT



LINDA M. HODGDON
Commissioner
(603) 271-3201

State of New Hampshire
DEPARTMENT OF ADMINISTRATIVE SERVICES
OFFICE OF THE COMMISSIONER
25 Capitol Street – Room 120
Concord, New Hampshire 03301

JOSEPH B. BOUCHARD
Assistant Commissioner
(603) 271-3204

February 5, 2013

Richard A. Mahoney, CPA
Director of Audits
Office of the Legislative Budget Assistant
State House Room 102
107 North Main St.
Concord, NH 03301

Dear Mr. Mahoney:

As noted by your office in its "executive summary," this audit is an examination of a general question: whether, during fiscal year 2012, State agencies made determinations regarding whether it was more cost-effective to hire personnel or instead contract for services. It is therefore not a typical audit focusing on the performance of a particular agency. The Department of Administrative Services ("DAS") is only one of the 21 agencies contacted by the Office of the Legislative Budget Assistant ("LBA") in relation to this audit. One agency other than DAS accounted for 64% of the total value of all matters reviewed (\$2.2 billion of the \$3.5 billion noted by the LBA is attributable to Medicaid managed care services). DAS-specific contracts make up only a portion of the remainder. Nonetheless, DAS is unique in that, in addition to procuring services for its own use, as do other agencies, it also procures service contracts for multi-agency use. Given our department's broad perspective, we have taken this opportunity to synopsise current procurement processes, offer some observations regarding the audit's recommendations, and highlight DAS' own extensive work in the area of service contracting.

i. Current Procurement Structure

As observed by the LBA in its 2009 Service Contracting Audit (which, like this audit, was not focused on the performance of any specific agency), the Legislature has established a generally decentralized procurement system relative to service contracts. This means that agencies generally contract for their own services of all types. The DAS Division of Plant and Property Management ("the Division") procures

service contracts which are intended for use by more than one agency. See RSA21-I: 11, I (f). In 2009, the Legislature adopted a provision specifying that agencies are required to actually make use of such contracts, rather than procure these services independently, unless granted a waiver from the Commissioner of Administrative Services. Those waivers are granted when the Commissioner "concludes that to do so would be in the best interests of the state." See RSA 21-I: 17-c. Among the multi-agency contracts which the Division has secured are those for fire alarm maintenance; HVAC maintenance and repairs; elevator inspection and repair; generator maintenance; fire extinguisher maintenance; trash and recycling services; mold and asbestos testing and removal; fire suppression testing and maintenance; and contracts for janitorial and snow-plowing services, to name a few.

The statutorily-mandated decentralization of service contract procurement means that departments generally assess the need for single agency service contracts independent of DAS. Factors involved in deciding whether services should be provided by use of outside contractors vary greatly depending upon the type of service, agency mission and funding at issue. DAS generally believes that agencies should (like DAS) assess the relative desirability of contracting for services versus handling those matters by the use of agency staff.

This assessment is necessarily a fact-intensive, mission-specific analysis, involving variables other than cost. Other factors which come into play might include, but are not limited to, the urgency of the need; the availability of resources; the skill level of existing State employees; the availability of proper equipment; the complexity of the task; the risk of injury or damage; quality control and security concerns. Individual agencies, which possess the greatest expertise in their particular subject areas, are in the best position to determine what factors are most important in given circumstances.

Currently, the Legislature specifies each agency's biennial budget at the "class" level. Agencies must present and justify their requests for funding of either contracted services or personnel. The Legislature has the ability to inquire into the details of any analysis made by the agency. If an appropriation is allowed for the acquisition of personal services, another level of review also generally exists. RSA 4:15 provides that the expenditure of any moneys appropriated to a department is subject to review by the Governor and Executive Council ("G & C"). In the case of contracts for personal services, most agencies are required to submit specific requests for G & C approval, containing a justification of their conclusions. Thus, under the current process, an agency's initial assessment of whether it is more appropriate to contract or use existing personnel is open to two levels of outside review.

In addition, RSA 124:15 generally provides that no new personnel positions or consultants may be created by the acceptance of money from any source without the approval of the Fiscal Committee of the General Court. The long-standing process for approval of such requests also requires an agency to justify its needs. Similarly, RSA 9:16-a requires that any transfer of funds within a department's accounting units in excess of \$75,000 be approved by both the Fiscal Committee and G & C. In short, safeguards are currently in place which allow the Legislature and G & C to ascertain whether proper, fact-specific analyses are being conducted. Finally, RSA 21-I: 17-c requires that multi-agency service contracts procured by DAS be used by agencies which are considering such services, unless granted a waiver by the Commissioner of DAS. Thus, yet another level of review exists to assure that the action is in the best interest of the State.

We believe that imposing additional statutory mandates as to the specific items which must be considered by agencies may create a level of unnecessary complexity, potentially resulting in unwarranted delay, increased overhead and loss of efficiency. Current assessment processes include flexible control while recognizing that, ultimately, individual agency heads are accountable for the level of service that they provide, the cost to provide those services, and operation within the constraints of the budget.

We note, however, that although practical difficulties would counsel against the imposition of additional statutory mandates on agencies seeking to address relatively routine contracting decisions, there may be a limited number of contexts in which a more formalized and comprehensive analysis would be appropriate. For example, if an agency seeks to privatize an entire program that is now handled by in-house staff, and if that privatization would permanently eliminate full-time classified positions, we believe that a comprehensive review would be in order.

Like other procurement determinations it makes, DAS' procurement of multi-agency contracts involves fact-specific assessments that are best addressed based upon practical experience. In the mid 1980's, for example, at the recommendation of a blue-ribbon committee, the State moved from in-house janitorial services to the use of outside vendors. This resulted in a significant decrease in quality and several security issues. Over time, State agencies became dissatisfied and began hiring of in-house janitorial staff; a determination which resulted in decentralization and cost inefficiencies. Since 2009, such independent procurement would generally be prohibited by RSA 21-I: 17-c and, based upon its experience, DAS ultimately implemented a blend of in-house and contracted janitorial services which it believes properly maintains State-owned facilities in a cost effective manner. The decision of whether or not

to secure these services by way of a contract or by use of in-house personnel proved to be specific to particular situations and buildings. In-house janitorial staff is, for example, used at "mission-critical" facilities such as the State House, State Laboratory, Emergency Operations Center and State Data Center in order to alleviate security and quality concerns. Generally, DAS measures the cost to maintain State facilities against the private sector where we are below the average cost per square foot.

II. Observations Relating to 2009 Audit

DAS notes that while the LBA's report mentions the 2009 Service Contracting audit, and while an appendix refers to the status of certain of the 2009 findings, the present audit is not identical in scope to the 2009 audit. That audit (which, like this one, did not focus on the performance of any specific agency) essentially contained fairly sweeping suggestions for the alteration of the State's procurement system. At least 22 of the 26 observations contained in the 2009 audit would have required statutory changes and, of the observations said to be capable of agency action without legislative alteration, not all were believed by DAS to be well-founded. Only one 2009 observation (number 18, recommending in part that the Legislature consider including in statute certain "need justification" requirements) appears relevant to the specific topic of the present audit. In response to that observation, DAS noted in part that one suggestion made by the LBA (that agencies be required to use statewide contracts when available) was then being considered by the legislature. That item has now been adopted as RSA 21-I: 17-c. The Legislature has chosen not to pursue the vast majority of the statutory changes suggested in the 2009 audit. Accordingly, DAS does not believe that the "Status of Prior Audit Findings," assessing progress toward these ends, is either relevant or necessary to this audit.

Moreover, we note that Appendix D selectively reviews the purported status of only 13 of the 26 observations made in 2009. To the extent that these items may be relevant to the present audit, the criteria for selection of these 13 items is not specified and inclusion of only these items may present a distorted picture of the significant strides made since 2009, even in the absence of a legislative overhaul of the State's purchasing system. Likewise, while Appendix D cites to the *title* of the recommendations made in 2009 (for example, item 15 "Improve Statewide Oversight") it does not identify the specific recommendations made under those titles, again potentially creating a skewed picture of agency activity.

III. Recent DAS Procurement Activity

Although the 2009 audit was not directed at the practices of any particular agency - and although neither that nor the present audit point

to particular failings which have resulted in increased costs to the State – DAS is proud of the progress that it has made in fostering greater efficiencies in the area of procurement, particularly in light of its significant staffing constraints. Since 2009, with no additional resources, the Bureau of Purchase and Property has:

- Put in place 202 new service contracts in 74 new areas. We are now focusing on management of those numerous contracts and developing methodologies to assure quality control. Agency and vendor survey forms are now being honed to aid in annual contract evaluations. No additional staff was allocated to achieve this result;
- Established multi-agency service and commodity contracts which expedite the States' response during an emergency. Examples include contracts with expedited response times for debris removal, rental of electrical generators, equipment, transportation and special-purpose refrigerated trailers;
- Developed provisions of the DAS Manual of Procedures which require agencies to link their bidding opportunities to our web site, thus creating a centralized resource for vendors;
- Maintained the central web site for posting of all American Recovery and Reinvestment Act (ARRA) bidding opportunities;
- Installed a module in the NH FIRST integrated financial system which expedites the purchasing process. The agency requisition process is now completely paperless and vendors may submit bids electronically;
- Trained staff and updated processes so as to prepare for the next steps in implementing a "strategic sourcing" module of NH FIRST. This module will allow vendors to submit and manage their vendor information without manual intervention by purchasing personnel and will expedite the bid receipt and evaluation process;
- Worked with legislators to develop and implement a statutory change raising the competitive bidding threshold from \$2,000 to \$10,000, thus expediting the purchasing process and allowing us to focus on service and commodity purchases of more significant value, such as our contracts for Pharmacy Benefits Management, or Administration of Medical Benefits. See RSA 21-I: 11, III (a);
- Worked to implement other laws relative to purchasing, including RSA 21-I:17-c (requiring agencies to use our multi-agency service contracts) and RSA 21-I:11-c (allowing for the debarment of

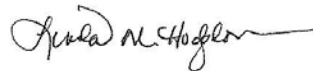
contractors that do not comply with contract requirements or who do not otherwise conform to certain standards); and

- *Established a multi-agency contract for "fuel cards," so as to replace individual agency fuel credit cards and foster the use of Department of Transportation fueling depots. The fuel card program (which has just completed its pilot stage and will be rolled out statewide in the near future) will eliminate the need for employees to use their private credit cards and generally foster more cost-effective fuel procurement practices. Fuel cards remove the state tax from the invoice, eliminating the need to seek reimbursement. Experience with this program has assisted us in formulating processes for potential use in other evolving areas, including general purchasing by way of State "procurement cards."*

These are only a few of the major strides which DAS is happy to report that it has made in areas connected to the 2009 audit, even in the absence of wholesale legislative change or increased staffing. Additional projects are also under development. We trust that the LBA's audit and appendices will not be construed as a negative assessment of the progress or commitment exhibited by DAS.

We would be happy to provide whatever additional information we can regarding the State's procurement system.

Sincerely,



Linda M. Hodgdon,
Commissioner

STATE OF NEW HAMPSHIRE
AGENCY DECISION-MAKING: EMPLOYEES VERSUS CONTRACTORS

APPENDIX C
SURVEY OF STATE AGENCY PRACTICES

We conducted a survey of a subjectively selected sample of State agencies to help identify which agencies used formal, informal, or no decision-making processes to decide to contract for a service or perform the service in-house using State employees. Twenty-one entities received surveys asking about the nature of their decision-making during SFY 2012. The survey had a 100 percent return rate.

1. During SFY 2012, did your agency have any service contracts in place?

Twenty-one agencies responded:

Yes	19	90%
No	2	10%

2. Why did your agency not have service contracts during SFY 2012?

Two agencies (10 percent) reported having no budget for service contracts.

3. For contracts in place during SFY 2012, did your agency conduct any analysis (formal or informal) to determine whether it would be better to contract versus performing the service in-house using State employees?

Twenty-one agencies responded:

Yes	14	67%
No	5	24%
N/A	2	10%

4. For contracts in place during SFY 2012, how often did your agency conduct a formal, written analysis to determine whether it would be better to contract versus performing the service in-house using State employees, considering:

A: Cost (e.g., comparison between in-house and contract costs)

Twenty-one agencies responded:

		Of 14 applicable:
All of the time	2	14%
Most of the time	1	7%
Infrequently	7	50%
Never	4	29%
N/A	7	

B: Effectiveness of service (e.g., how well the service could meet agency needs)

Twenty-one agencies responded:

		Of 14 applicable:
All of the time	3	21%
Most of the time	1	7%
Infrequently	6	43%
Never	4	29%
N/A	7	

C: Risk (e.g., problems which may arise)

Twenty-one agencies responded:

		Of 14 applicable:
All of the time	1	7%
Most of the time	2	14%
Infrequently	6	43%
Never	4	29%
N/A	7	

D: Other (please specify below)

Five agencies provided other responses:

- **Written analyses are performed in connection with formal bid requests via RFPs. All contracts put in place in SFY 12 were done only in cases where knowledge/expertise was critical to agency's statutory mission.**
- **Ability to perform with in-house resources.**
- **Most of the contracts were to provide a specific function. To hire contractors is always less than additional staff, no benefits.**
- **Always perform an informal cost benefit analysis before determine to use contractors.**
- **Physical security and clearance issues; firewall concerns.**

5. For contracts in place in SFY 2012, how often did your agency conduct an informal analysis to determine whether it would be better to contract versus performing the service in-house using State employees, considering:

A: Cost (e.g., comparison between in-house and contract costs)

Twenty-one agencies responded:

		Of 14 applicable:
All of the time	7	50%
Most of the time	3	21%
Infrequently	3	21%
Never	1	7%
N/A	7	

B: Effectiveness of service (e.g., how well the service could meet agency needs)

Twenty-one agencies responded:

		Of 14 applicable:
All of the time	9	64%
Most of the time	3	21%
Infrequently	2	14%
Never	0	0%
N/A	7	

C: Risk (e.g., problems which may arise)

Twenty-one agencies responded:

		Of 14 applicable:
All of the time	8	57%
Most of the time	4	29%
Infrequently	2	14%
Never	0	0%
N/A	7	

D: Other (please specify below)

Six agencies provided other responses:

- **All the time. Inherent in the consideration of every service contract is the ability to perform the service in-house due to internal controls, knowledge/expertise,**

- **Sufficiency in staffing levels, and whether the cost/time to perform the service in-house is sufficiently outweighed by saving significant time/money to contract out.**
 - **All the time. Ability to perform with in-house resources.**
 - **Infrequently. As stated above most of the contracts were for specific services, generally funds were received from another agency for us to provide specific services or we did not have the expertise for the necessary service.**
 - **All the time. The most important aspects of in-house verses contractor deals with skill sets needed to perform the job, required expertise to perform the work and availability of staff time to perform the work.**
 - **All the time. An informal cost benefit analysis is done before determining the use of contractors to perform a statutory or required function of the Department.**
 - **All the time. Physical security, clearance issues, applicability/allowabililty for federal connectivity, and firewall concerns.**
6. Has your agency ever done a cost-benefit analysis (formal or informal) to determine whether it would be better to contract for a service or use in-house State employees which resulted in keeping a service in-house?

Twenty-one agencies responded:

Yes	9	43%
No	12	57%

7. From SFY 2009 to SFY 2012, did your agency ever consider bringing a contracted service in-house?

Twenty-one agencies responded:

Yes	12	57%
No	9	43%

8. Please list the contracted service(s) your agency considered moving in-house (regardless of whether or not the services were ultimately moved in-house).

Twelve agencies listed 43 services they considered moving in-house.

9. Please provide any additional comments you may have related to the decision to contract for a service versus performing the service in-house using State employees:

Twelve agencies provided additional comments:

- **The agency makes informed decisions to contract for services only in limited instances where it lacks knowledge/expertise in the relevant arena needed, has insufficient staffing levels to perform the service itself, or the cost/time to perform the service in-house is sufficiently outweighed by saving known significant time/money to contract out.**

- It is virtually impossible to hire new employees therefore contracting is necessary.
- Several factors other than cost are considered in weighing whether to utilize in-house versus contractors; availability and skill level of in-house personnel, critical nature of work and time line requirements, sensitive or confidential nature of work requirements, risk assigned to the project to guarantee successful completion of the tasks involved.
- We are short staffed as it is and to bring services in-house would jeopardize the programs as well as the regular work of staff.
- The service contracts we have are goal specific, our staff do not have the time or expertise to accomplish these.
- Beyond cost, there is the consideration for timeliness of delivery and whether State staff has the necessary skills and experience to deliver the desired product.
- State budgets and policy provide disincentives for performing services in-house versus contracting for such services. Bringing contracted services in-house exposes the service to hiring freezes, if the services are not direct care. Thus projects are at risk for failure if vacancies are not filled. Creating new State positions to staff a transition from contract to in-house is prohibited outside the biennial budget process. State salary scales are too low to attract and retain professionals in certain fields requiring specialized skills such as medical professionals, high level finance staff, and systems people.
- Due to the technical and specialized nature of the services contracted for, we did not perform any analysis as it was and is management's belief the professional services provided through these contracts are specialized, critical to the State's business, and not likely to be the training and background of State employees.
- We considered using contracts for some things we were going to undertake but never did undertake them.
- The contracts are predominately service contracts that were for the performance of a specific function or expertise.
- There have been several occasions in the past three years that we have found that because of changes in regulation, we sometimes have to hire outside consultants due to the tight deadlines on the project itself. At the same time we would begin the process to train our current staff, or work with Personnel to rewrite job descriptions on open positions to work toward hiring someone or teaching our current staff to perform the new skill set that we have found we will need going forward. Personnel changes sometimes take a while and most of the projects that we hire outside consultants for must be completed with a few month time frame. This two prong approach has been working fairly well for us and has led to now having two individuals who can act as hearings officers in house so we do not have to consistently hire outside contractors for these types of administrative cases.
- The cost of benefits in our State typically tips the scales over allotted dollar amounts available for services and makes the decision easier to hiring a contractor for those outside services. Personnel issues and dealing with problem employees vs. contractors is also a large consideration.

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**STATE OF NEW HAMPSHIRE
AGENCY DECISION-MAKING: EMPLOYEES VERSUS CONTRACTORS**

**APPENDIX D
STATUS OF PRIOR AUDIT FINDINGS**

The following is a summary of the status of observations applicable to this performance audit found in our *Service Contracting* performance audit report from March 2009. In 2009, we did not audit individual contracts or contracting at any one agency. While the recommendations in many observations focused on the Department of Administrative Services (DAS) in its role as the State's central service provider, the audit examined the statewide service procurement system. Most of our recommendations required significant legislative changes to provide the DAS needed authority. The full extent of our recommendations could not have been implemented immediately and improvements in management controls statewide could only be realized in the long term following statutory changes. The resolution status of the 13 observations listed below reflect, in many instances, the limited number of statutory changes made since 2009.

<u>Status Key</u>				
Fully Resolved	●	●	●	0
Substantially Resolved	●	●	○	0
Partially Resolved	●	○	○	6
Unresolved	○	○	○	7

Service Contracting (March 2009)

<u>No.</u>	<u>Title</u>	<u>Status</u>		
1.	Centralize Service Procurement	○	○	○
2.	Expand Multi-Agency Service Contracts	●	○	○
3.	Amend State Procurement Statutes	○	○	○
4.	Promulgate Service Contracting Administrative Rules Binding On All State Agencies	○	○	○
5.	Revise Statewide Policy Documents And Guidance To Agencies	●	○	○
6.	Consolidate And Update Competitive Procurement Thresholds	●	○	○
7.	Implement Standard Language, Forms, Templates, And Guidelines	●	○	○
11.	Use Information Technology To Improve Procurement Processes	●	○	○
14.	Provide Comprehensive Review And Oversight Of Individual Contract Processing	○	○	○

- 15. Improve Statewide Oversight
- 16. Seek Governor And Council Review And Approval For Service Contracts On An Individual Basis
- 18. Consistently Require Formal Justification Of Service Contract Need
- 25. Develop And Implement A Statewide Debarment Process

All performance audit reports, and financial audit reports issued in 1995 and later, may be obtained online at our website <http://www.gencourt.state.nh.us/LBA/audit.aspx>. Copies of financial audit reports issued before 1995 may be obtained from the Office of Legislative Budget Assistant Audit Division, 107 North Main Street, State House, Room 102, Concord, NH 03301-4906.