Ohio Legislative Service Commission

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Fiscal Note & Local Impact Statement

Bill: H.B. 436 of the 128th G.A.

Date: February 4, 2010

Status: As Introduced

Sponsor: Reps. Balderson and Boose

Local Impact Statement Procedure Required: No — No local cost

Contents: Provides new procedures for contracting out for goods or services provided by state agencies

State Fiscal Highlights

- **Contracting out – business cases**. The bill requires state agencies to present business cases for contracting out the provision of goods or services to the Council on Efficient Government, which the bill creates. While the bill requires business cases to contain evidence of any savings expected to arise from contracting out, overall savings to the GRF or other state funds would depend on a variety of factors.
- **Supporting the Council on Efficient Government.** The Auditor of State would incur increases in GRF administrative costs to provide staff support and reimburse private-sector members of the Council on Efficient Government for their expenses.
- **Conducting contractor audits.** The Auditor of State would likely incur increased expenses from the Public Expense Audit – Intrastate Fund (Fund 1090) to conduct audits of contractors and subcontractors for services outsourced under the provisions of the bill. Some of these expenses may be offset by audit fees.

Local Fiscal Highlights

- No direct fiscal effect on political subdivisions.

Detailed Fiscal Analysis

Overview of the bill

The bill creates a new set of requirements for contracting out of goods and services provided by state agencies. The bill authorizes an eligible state agency to outsource its duty to provide a good or service to a private contractor through a competitive and confidential request for proposal (RFP) process. Each agency would be required to develop procedures for issuing RFPs and evaluating responses based on their advantageousness to the state using price and other criteria, including the advisory report of the Council on Efficient Government, which is established in the bill. The legislative and judicial branches of government, the statewide elected officials, and the Ohio Department of Transportation (ODOT) contracts for planning, development, implementation, operation, or maintenance of ODOT's road, bridge, and public transportation construction program are excluded from the bill's contracting requirements.

Business case for contracting out

Before issuing an RFP, a state agency would be required to submit a business case to the Council on Efficient Government that includes, among other requirements, a cost-benefit analysis of the proposal to contract out and a transition plan for addressing the status of state employees that would be dismissed as a result of a service or good having been contracted out. Agency heads would be required to sign off on the feasibility of achieving the cost and savings goals presented in each business case. The bill includes separate requirements for issuing RFPs and filing business cases with the Council on Efficient Government depending on the projected annual costs of contracting out for a good or service (less than $1 million, between $1 million and $10 million, and $10 million or more).

The bill sets out requirements for each contract entered into under the bill, including requirements relating to quality and performance standards, payment plans, contingencies, maintenance of accounting records, state audits (see below), public records, and intellectual property. The bill also requires that contracts include an article that requires contractors to consider for employment those state employees that were displaced by an agency contracting out for a good or service.

Governor's selection of goods or services to be outsourced

Finally, beginning on July 1, 2012 (the start of FY 2013), the bill requires the Governor to choose, at least once every two fiscal years, at least three goods or services provided by a state agency that the Governor believes could be contracted out to the private sector and submit those choices to the Council on Efficient Government for review and evaluation.

Fiscal effects

Business case for outsourcing

Under the bill, while agencies could incur some additional expenses to prepare business cases for review by the Council on Efficient Government, these costs are unlikely to be more than minimal. Business cases must include several pieces of information, including, among others, (1) the current costs for performing the service or function proposed to be contracted out, (2) the goals to be achieved by contracting out, and (3) a data-supported cost-benefit analysis of contracting for the service. Assuming that each contracting plan approved by the Council would result in net savings to the state agency proposing it, the bill, once fully implemented, could result in a decrease in state expenditures to the GRF and other state funds.

The extent of these savings would depend on the specific set of circumstances surrounding each contracting proposal. Although cost avoidance is one of the principal reasons for outsourcing government functions or services to the private sector, Section 121.82 of the bill delineates other factors and criteria that an agency would be required to evaluate in preparing a business case. Studies on the topic of public sector outsourcing suggest that a decision to outsource a service or function requires changes in work and management practices and contract oversight procedures.[1] How these factors are addressed will determine any new costs incurred or savings achieved from contracting out, both in the short and long run. Specific costs that are typically considered are (1) the cost to complete the contracted project, (2) new costs related to contract oversight and management, and (3) ongoing costs once a contracted project has been completed.[2]

Audit costs

The bill requires that all contracts for goods or services include a provision that the private contractor or subcontractor be audited by the Auditor of State. The bill does not specify if these are to be financial audits, performance audits, or both; however, this analysis assumes that these would be financial audits. Although current law authorizes the Auditor of State to engage in audits of certain private entities that receive state funding, the Auditor does not routinely engage in audits of private contractors. As a result, the Auditor of State is likely to incur new costs in order to fulfill the provisions of the bill, depending how this requirement is implemented. Any new costs would hinge on the number of private contractors and subcontractors subject to audits under the bill,

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[1] Griffith, Gareth and Honor Figgio, "Outsourcing in the Public Sector," New South Wales Parliamentary Library Research Service, November 1997, http://www.parliament.nsw.gov.au/prod/parlment/publications.nsf/0/EF5487324EB40557CA256ECF000A1FE5/$File/22-97.pdf.

[2] "Outsourcing Strategies: Guidelines for Evaluating Internal and External Resources for Major Information Technology Projects," Texas Department of Information Resources, http://www.dir.state.tx.us/oversight/outsourcing/outsource1.htm#ExecutiveSummary.

and potentially the number of new staff required for the Auditor of State to conduct these audits.

Currently, financial audits of state agencies are funded through line item 070601, Public Audit Expense – Intrastate, within the Public Audit Expense – Intrastate Fund (Fund 1090). Appropriations for this purpose are $11.0 million in each fiscal year for the FY 2010-FY 2011 biennium. This appropriation is supported by fees charged to state agencies for annual, biennial, and special audits conducted by the Auditor of State. The billable hourly rate for FY 2010 is $64.43.

It is unclear how the bill's requirement for the audit of private contractors would be incorporated into the Auditor's current duties concerning audit oversight of state agencies. One potential issue is the question of whether an audit of a state agency would also include an audit of any contractors working for a state agency pursuant to the bill's provisions, or if the contractors would be audited on a separate basis. Nevertheless, Fund 1090 appears to be the most likely current funding source to support these additional expenditures. Additional costs to the fund may be offset by any fees charged for the purpose of contractor and subcontractor audits.

Council on Efficient Government

The bill establishes the Council on Efficient Government to consist of seven members, three appointed by the Governor and four appointed by legislative leadership. The Governor would appoint one member who is the chief executive or administrative head of a state agency and two members who are engaged in private enterprise, while the Speaker of the House of Representatives and the President of the Senate each would appoint two members representing private enterprise. Initial appointments must be made on or before January 1, 2011, halfway through FY 2011. The Council's members would elect a chairperson and serve two-year terms after the terms of initial appointment expire and would serve without compensation, except that the private-sector appointees would be reimbursed for their expenses.

The bill requires the Auditor of State to provide staff support to the Council and outlines specific duties that the Council must undertake. These include:

- Conducting public hearings;
- Handling complaints and violations concerning the bill's contracting provisions;
- Soliciting petitions of interest for contracting from private contractors; and
- Producing advisory reports and an annual report.

Because these responsibilities are extensive, it is possible that the Auditor of State would have to hire some additional employees for these purposes. This would depend on whether existing Auditor of State staff possess the "significant expertise and experience" required by the bill, and the extent to which these responsibilities could be integrated into the Auditor's existing workload. The administrative costs the Auditor of State would incur appear to fall outside the office's normal public audit duties, and would thus most likely be funded through GRF line item 070321, Operating Expenses, appropriated at $29.3 million in each fiscal year of the FY 2010-FY 2011 biennium, as opposed to other sources of funding that are set aside for specific auditing functions.

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