



## OFFICE OF THE LEGISLATIVE AUDITOR

STATE OF MINNESOTA

FEBRUARY 1992

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# State Contracting for Professional/Technical Services

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STATE OF MINNESOTA

**OFFICE OF THE LEGISLATIVE AUDITOR**

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JAMES R. NOBLES, LEGISLATIVE AUDITOR

February 14, 1992

Representative Ann H. Rest, Chair  
Legislative Audit Commission

Dear Representative Rest:

Over the last decade, policy makers have shown increased interest in innovative methods of accomplishing public goals, particularly those that employ the private sector to deliver services. The Legislative Audit Commission directed us to evaluate Minnesota's experience in contracting for professional/technical services and to assess whether the state should increase its contracting activities.

Although contracting is common in Minnesota, our evaluation found that it is not always well managed. The process of contract approval is cumbersome, and the state lacks adequate cost and performance information to assess whether increased contracting might save money. We recommend streamlining the review and approval process, better management and monitoring of contracts, and stronger guidance for state agencies that are considering new contracting opportunities.

We received help from numerous state agencies during this study, particularly the Department of Administration.

The report was researched and written by Marilyn Jackson-Beeck (project manager) and Jo Vos, with assistance from David Chein, Joel Alter, and Jan Sandberg. Alanna Tyler, Nancy Van Maren, and Bruce Williams served as interns on this project.

Sincerely yours,

James Nobles  
Legislative Auditor

Roger Brooks  
Deputy Legislative Auditor

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# STATE CONTRACTING FOR PROFESSIONAL/TECHNICAL SERVICES

## Executive Summary

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**R**ecent financial problems have caused a renewal of interest in alternative ways to run state government and deliver public services. One often mentioned possibility is to let others, especially private businesses, provide more goods and services. It is argued that market forces and free enterprise can yield equal or better quality goods and services at lower cost than state agencies with their own employees.

It is not easy, however, for state government to purchase goods and services from outside sources. Reliable cost and quality comparisons are often hard to make, and state agencies must comply with numerous rules and procedures to meet the requirements of public accountability. In other words, contracting with outside sources is itself a complex and difficult management challenge.

We were asked by the Legislative Audit Commission to study state contracting. Our study focused on the broad category of professional/technical services rather than commodities. We focused on these key questions:

- **How much do state agencies spend on contracts for professional/technical services? Why have they hired contractors, and are they satisfied with the results?**
- **What process must state agencies follow when contracting? How long does it take? How could the process be improved?**
- **What are the costs and benefits of providing services through state employees versus contractors?**

In general, we found that state agencies are satisfied with contractors' performance, but they sometimes lack information which would allow them to determine the costs and benefits of various alternatives. In addition, we found that contracts are not always managed efficiently and effectively, and the state's regulatory efforts are sometimes uncoordinated. Until such problems are resolved, in our opinion, the effects of increased state reliance on alternative service providers are uncertain and may not be entirely beneficial.

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**It is not easy for state agencies to contract for services.**

## CONTRACTING BY STATE AGENCIES

The term "contract" refers to written instruments containing the legal elements of offer, acceptance, and consideration to which a state agency is party. Our study focused on 2,922 professional/technical service contracts which the Department of Administration approved during fiscal year 1990. The term "professional/technical" includes various services from consultants, professionals, and technical workers, as well as computer-related services, construction projects, and miscellaneous activities.

### Expenditures

Based on contract records for fiscal year 1990, the most recent complete source of data when our study began:

- **The Department of Administration approved expenditures of \$495,878,978 in professional/technical contracts.**

About three-quarters of this amount was for construction projects by the Department of Transportation, but about one-fourth of all professional/technical contracts were estimated at \$3,000 or less. The largest contract in fiscal year 1990 was for \$68 million, for the intersection of Trunk Highway 100 and Interstate 394, and the smallest was for \$80, to provide an artwork.

**Professional/  
technical  
contracts  
ranged in value  
from \$80 to  
\$68 million.**

### Required Reports

State law requires the Commissioner of Administration to describe the amount and purpose of professional/technical contracts in monthly and quarterly reports to the Governor and Legislature. However, we found that:

- **The department has not produced quarterly, summary reports--only partial, monthly listings of professional/technical contracts which it has approved, and none which it has disapproved.**

We reviewed several of the monthly listings, each of which is about ten pages long. The only summary information we found was the total estimated cost and the subtotal for each department. But this information could be misleading: the totals and subtotals combine the estimated cost of new contracts with additions and subtractions to old ones.

### Types of Contracts

We analyzed a sample of 39 percent of the 2,922 professional/technical contracts and found that 64 percent were for goods and services such as the production of a video program, medical tests, and software maintenance.

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**Most contracts are for building operations, real estate, and construction.**

Twenty-two percent were for research and opinions including a computer needs study, consultation on security, and an evaluation of a grant application. Ten percent of the contracts were for training and instruction, and four percent were for miscellaneous items including live entertainment.

Looking at the contracts by subject, we found that 23 percent were for building operations, real estate, and construction of various types. Nineteen percent were for health care, 10 percent involved the environment, agriculture, and science, 7 percent concerned advertising and communications, and 6 percent each were for computer information systems, management and finance, and architecture and engineering. No other subject captured more than five percent of the total.

## **Agencies' Use of Contractors**

To examine state agencies' use and management of professional/technical contracts, we conducted in-depth interviews and reviewed paperwork for 36 medium-to-large contracts in 18 major departments. In nearly half the cases, program managers were actively working with the contractors and expected to continue. On the average, the contractors had worked for the state for about five years.

In some instances, contractors were so well integrated with agency operations that they were hard to tell apart from state employees. Often, they provided some departments' ongoing tasks and services such as data processing, psychiatric services, magazine production, and debt collection. As shown in the table, most of the remaining contracts were either to start a program or system, or to do a one-time project, event, or report. Examples of these contracts included a study of the care given to Medicaid recipients, landscaping, installation of a computer system, and training sessions.

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## **Main Work to be Provided by Professional/ Technical Contracts**

	<u>Number</u>
Ongoing tasks or services	17
Start-up of new or additional program or system	8
One-time or special project, event, or report	8
Other, unclassified	2

Source: Questionnaires from program managers for 35 of 36 selected contracts.

Note: The question was: "What type of work was this contract primarily intended to provide?"

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According to program managers, the most common explanation for professional/technical contracts was that they provided special expertise. Also, in 14 cases, program managers said that the contracts were related to staff shortages. Eleven program managers indicated that their professional/technical contracts were the customary way to get a particular job done. As shown, time constraints and external requirements such as federal, executive, or legislative directives further explained why state agencies hired professional/technical contractors.

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### Major Reasons Why Agencies Wrote Professional/Technical Contracts

	<u>Number</u>
Needed special expertise	26
Staff shortage	14
Traditional practice	11
Time constraints	6
Federal requirement	5
Legislative or executive request	5
Needed objective outsider	2
Other, unclassified	7

Source: Questionnaires from program managers for 35 of 36 selected contracts.

Note: The question was: "Which of these reasons describe why your department entered into this contract?" More than one reason could be marked.

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**Contractors  
often help to  
provide state  
agencies'  
ongoing  
services.**

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### Contractors' Performance

We asked the program managers to rate their contractors' performance on a ten-point scale. Most of the program managers gave their contractors a score of at least eight, but others could not make a judgment. On a standard evaluation form which the Department of Administration requires agencies to complete, only one program manager reported that the contractor's services were unsatisfactory.

While they generally maintained positive relationships with state agencies, contractors' work was usually adequately controlled. In cases where individual contract workers performed badly, the state managers could sometimes get replacements.

In general, professional/technical contracts gave state managers a welcome measure of freedom from personnel problems. Also, in light of fluctuations in work flow and uncertainty about budgets, the program managers were glad for the opportunity to contract for services on a time-limited basis although they seldom canceled contracts and often extended them.

## Questionable Cases

Although most program managers were pleased with contractors' performance and reported only minor difficulties managing the work, we found some exceptions and reasons for policymakers to be concerned.

- **A few contracts had several serious problems.**

In one case, a program manager stated that the \$280,000 project was overdue, and contract workers at times had almost completely disregarded the department's goals and objectives while submitting work that did not meet requirements. The manager added that state employees had to help the contract workers because they lacked certain technical skills.

In another case, an agency reported that a contractor did not provide help when it was needed. The contractor visited the agency once a month, but the technical nature of the work inhibited good communication with the program manager. The agency questioned whether the contracting firm was adequately staffed and said it was initially difficult to track the contractor's progress.

These situations illustrate the complexities of successfully using professional/technical contracts. In other cases, the issues were simpler.

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### **Competition for contracts was often absent.**

First, we found that competition for the contracts occurred only about half the time. For example, according to two program managers, their contracts went without publicity, partly because they had bad experiences with previous vendors.

Second, state agencies sometimes exercised weak control over contractors' activities. In one case, an agency originally asked contractors to propose as much work as they could for \$2 million. According to the program manager, this way, the selection committee would not have to choose the lowest bidder for any given set of required services.

Third, program managers indicated that the cost of services through contracts, including administration, may have been higher than alternatives in eight cases. However, some pointed out that the extra costs were unavoidable because they could not hire additional state employees to do the work.

Our fourth concern was that some contracts arose because of problems between state agencies. For example, one program manager explained that his agency had to hire computer programmers under contract because it had purchased a particular type of computer which the Department of Administration did not support. Another manager said that the Department of Employee Relations lacked the staff and financial resources to provide quality training classes, so it used a contractor instead.

In five cases, program managers indicated that the quality or quantity of contractors' work had a negative effect on state projects. One such case involved

a contractor who operated a messy waste-handling facility, which the agency had to close for two weeks while the contractor cleaned up.

Finally, we were concerned about the potential for conflict of interest in two cases. In one of these, a program manager told us that her department made it very clear to a contractor that future hardware purchases were contingent on getting a good price for a software development contract. The department advertised the contract but received only one proposal, from the hardware manufacturer. The second case involved a former parttime state employee who, while still on the job, had her own consulting business and proposed to work for her department as a consultant.

## PROCESS OF CONTRACTING

Most program managers we interviewed (26 of 36) were critical of the state's procedures for contract review and approval. The biggest problem was that:

- **The process took so long that in some cases agencies violated the law by allowing contractors to begin work before contracts were valid.**

**Most contracts have to be approved by three separate agencies.**

Despite the law, program managers were convinced that it sometimes made economic sense to let contractors begin before contracts were final. On the other hand, some managers went to great lengths to validate contracts before work began. One told us that he hand-carried half of all his professional/technical contracts to the Department of Administration for review and approval.

Some managers saw little or no value in the work of reviewers from the Departments of Administration and Finance. To more than one agency, they merely seemed to rubber-stamp contracts and shuffle papers.

## Review and Approval Procedures

State law says that professional/technical contracts are not valid until approved in writing by the Commissioner of Administration, the Attorney General, and the Commissioner of Finance. The Department of Administration has overall responsibility for contract management and review. The Attorney General's main responsibility is to see that contracts are consistent with legal requirements. The Commissioner of Finance is primarily responsible for seeing that agencies have set aside enough money to cover contract costs.

We found that all of these external reviewers independently followed written, sometimes duplicative, procedures and consulted statutes while carrying out their duties. Overall, we concluded that:

- **The state's procedures for reviewing and approving professional/technical contracts are generally well founded, but**

**they have been implemented inefficiently and are poorly coordinated among the Attorney General's Office and Departments of Finance and Administration.**

However, we also found that state agencies' own practices sometimes cause significant delays.

## **Reasons for Delays**

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**State agencies' own practices cause some delays.**

Depending on the size, complexity, and specific features of contracts, it takes attorneys about a week to review, approve, and return contracts to state agencies. After that, the Departments of Administration and Finance together take roughly two weeks to review, approve, and return contracts to agencies, usually by inter-office mail. In these two departments, staff usually review the contracts in the same order as they are received, without regard to dollar value or other characteristics. If agency representatives personally walk or rush their contracts through the process, they can possibly get approval in a day or two, not counting attorneys' time.

Records at the Department of Administration indicated that staff returned about ten percent of professional/technical contracts to agencies for corrections or further information, before granting final approval. In addition, the department returned five percent of agencies' requests for prior approval (required before writing larger contracts), and the Department of Finance returned two percent of the contracts it reviewed. However, the return rate varied widely by agency.

Among other reasons, the Departments of Administration and Finance returned contracts because of missing signatures and unclear references. In other cases:

- **The Departments of Administration and Finance delayed approving contracts because they suspected that work had already begun without legal authorization.**

We found that both departments scrutinize the anticipated effective date on professional/technical contracts and demand a written explanation when they see that it has passed. But since contracts do not indicate when or if work actually began, agencies sometimes are innocent of wrongdoing. Moreover, contracts' effective dates sometimes pass because the reviewers take longer to do their work than agencies originally plan.

Another factor that affects the length of the review and approval process is the time of year when contracts are written. Agencies submit a crush of contracts for review and approval in the summer, when one fiscal year ends and the next one begins (July 1). During the high season, the Department of Administration has had a backlog of as many as 15 working days. The Department of Finance told us that its processing can take five to six days in the peak period compared with three to four days at other times.

A third reason why state agencies wait so long for contracts to be reviewed and approved is that the Department of Administration has assigned only one contract administrator and one documents assistant to handle about 3,000 professional/technical contracts annually, along with approximately 9,000 other important documents. The administrator answers many questions by telephone and provides agencies with written policies and procedures but, unfortunately, the department's manual is out of date, incomplete, and sometimes inaccurate. Neither has the department conducted regular training sessions nor used its computerized data to manage its workload more effectively.

## Procedures and Guidelines

According to the Department of Administration's manual of policies and procedures, agencies can write an "annual plan" memo to justify their need for minor professional/technical services. The anticipated contractors need not be listed, but, according to the manual, they can each receive a maximum of only \$500 during the entire fiscal year.

During fiscal year 1990, annual plan memos accounted for nearly \$11 million in services. We also found that, despite the \$500 cap which is indicated by the manual:

- **The Department of Administration has approved as much as \$2,000 per firm or individual through annual plan memos and \$5,000 for one agency.**

Staff explained that they overrode the manual with a memo which states that the department's policy is actually to determine the maximum allowable amount case by case. Some other discrepancies in the department's manual also have been corrected by staff memos, but these may not reach the program managers who need current information.

The manual provides some useful guidance concerning activities that would be inappropriate for government contractors. The U.S. General Accounting Office recently said Minnesota was the only state to provide such guidance to its agencies, although we think the Department of Administration should review the guidelines and offer more helpful advice on the conditions that make contracting desirable.

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**The Department of Administration should develop better guidelines for contracting.**

## COST-BENEFIT COMPARISONS

We identified several areas of state government where contractors have replaced or supplemented the work of state employees, or where the potential or desire for greater use of nonstate workers exists. In light of program managers' general satisfaction with contractors, we asked why state employees would provide some services when alternatives are available. Specifically, we analyzed the major monetary and nonmonetary costs and benefits of the state

providing a range of six different services which are available on the open market: nursing homes, tree nurseries, computer programming and systems analysis, printing, fish rearing, and motor vehicle registration.

We would have preferred to analyze additional services, but often the state had too little information about its own activities to compare the costs and benefits of others providing public services. For example, the Department of Transportation has yet to determine its actual costs for highway maintenance despite running several satisfactory pilot projects with private contractors in 1982-83.

In the six cases where we were able to directly compare the costs and benefits of state employees versus others providing similar services, the results generally indicated that:

- **State agencies sometimes have provided their services with little attention to costs or alternatives.**

For example, we studied nursing homes which are operated by the state as well as nonprofit, for-profit, and city/county governments and found that:

- **Overall, nonstate nursing homes charged about 40 percent less to provide similar nursing home services than what it cost in state nursing homes during 1989.**

Our study suggested that most residents of the state's major nursing home (Ah-Gwah-Ching, near Walker) needed about the same type of care which is available in the state's many nonstate nursing homes. However, median nonstate salaries were 20 to 40 percent lower than in the state's major nursing home, and the state used more staff per resident. Another reason for the state's high costs at Ah-Gwah-Ching is the facility's age and 219-acre campus.

When we studied the price of tree seedlings from the Department of Natural Resources compared with private growers, the results showed that:

- **State prices were far lower, but costs have exceeded revenue despite the Department of Natural Resources' efforts to make the state's tree nursery program self-sufficient.**

The Legislature appropriated funds to the nursery account during fiscal year 1984 to help establish a working capital base. However, since fiscal year 1985, the fund's operating cash balance has dropped by almost \$700,000. In a 1989 financial audit, our office recommended that the department change its pricing structure to: (1) incorporate various depreciation factors, (2) use fiscal rather than calendar year costs to ensure the most current cost data, and (3) build in anticipated wage increases. Now, the department is trying to reduce operating costs and is considering hiring contract workers rather than seasonal state employees.

In a third case, we compared hourly prices for routine computer programming and systems analysis by state employees versus private firms which provide similar services to various state agencies through contracts. The data indicated that:

- **Although the state's rates were higher than its private contractors, they were too low to cover the computer programmers' and systems analysts' share of indirect costs at the Department of Administration in 1991.**

The department itself calculated that the state employees' rates should have been 13 to 40 percent higher to cover all indirect costs that year, but managers got approval to charge less than the full amount. One reason for the disparity is that the department's indirect costs are inflated and subject to internal dispute. According to the KPMG Peat Marwick accounting firm, which the department called in as a consultant, similar public and private data centers across the nation have 37 percent fewer staff than Minnesota and spend 18 percent less. Another reason for the disparity is that the department selects contractors partly on the basis of their low prices. Recently, the department has been diligently reviewing its activities and is planning major changes.

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**There are sometimes valid reasons--including lower costs--for the state not to contract for services.**

Fourth, we examined state and private printing prices for four specific documents. The results showed:

- **The State Printer's price for printing selected documents was lower than state agencies were likely to get by shopping on their own in St. Paul, but the state's rates were set too low to cover costs.**

When the department compared its printing rates to actual costs for fiscal year 1991, 14 of the 21 rates were underestimated. Overall, the rates should have been about one percent higher. However, the state's fiscal condition makes it difficult for the department to make accurate projections of printing volume, and we recognize that the department has since adjusted the rates and reduced personnel in hopes of better results during the 1992 fiscal year.

In our fifth and sixth case comparisons, we learned that the state sometimes saves or makes money even though it duplicates services which are available elsewhere. For example, a recent study by KPMG Peat Marwick compared the cost to raise fish through the Department of Natural Resources versus private sources. Its findings were that:

- **Partly because the Department of Natural Resources raises large numbers of fish, the cost was the same or less in most cases than it would have been for the state to purchase the same species from private sources.**

The department's costs were lower than private sector prices for seven varieties of fish, higher for five, and about the same for two. Moreover, the department's lower prices applied disproportionately to the species which it stocks

most heavily in state waters. The Department of Natural Resources now purchases two species which were costly for it to produce but continues to raise fish such as walleye which it stocks heavily and produces cheaply.

Finally, we examined the reasons why the Department of Public Safety processes motor vehicle registrations at a public counter when cities, counties, corporations, and private individuals routinely handle most transactions. Our analysis disclosed that:

- **Through its public counter, the Department of Public Safety expects to make about 12 percent more than it costs for each motor vehicle transaction, and it collected about \$1 million which was split between the general fund and highway user tax distribution fund over the past two fiscal years.**

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**State officials should exercise caution as they consider contracting opportunities.**

Like all other registrars, the department collects a fixed fee of \$3.50 for each motor vehicle registration. We found that legislation has increased the reimbursement rate beyond inflation in Minneapolis-St. Paul since 1978.

## OVERVIEW

We think that Minnesota state officials should exercise caution as they consider extending the state's reliance on contractors. Contracting is already common in state government, but contracts are not always processed and managed efficiently and effectively. Also, contracting is not often used today as a cost-saving measure, and sometimes it can cost more to use contractors than state employees.

Overall, five general problems help to explain why state contracting so far has been inefficient. These are:

- **inadequate information on the relative costs and benefits of providing service through the state versus alternatives,**
- **sketchy guidelines and complex procedures for state agencies,**
- **inefficient contract review and approval activities,**
- **weak management by some agency staff, and**
- **lack of a state strategy for contracting and other alternatives.**

Our specific recommendations could yield better information and smooth the way for managers to improve the state's process for reviewing and approving professional/technical contracts. But, because such contracts so often are project-specific, it is difficult to say precisely how agencies could better manage.



Concerning the state's strategy for contracting, state agencies' use of state employees to provide services might be justified despite the availability of alternatives in these types of situations:

- **It takes little time for employees to provide the services as part of or in addition to their routine activities.**
- **The state has already made a significant investment in facilities or equipment which has not outlived its usefulness.**
- **The activity is closely tied to the agency's distinctive objectives.**
- **The activity helps to run the agency, especially by generating revenue or reducing costs.**

For example, we found that state tree nurseries are closely related to the state's responsibility for forest management, and low-cost seedlings may encourage public reforestation efforts which are ultimately good for the state and its economy. Likewise, seasonally raising fish is only a small part of the state's responsibility for fish management, while fishing is vital to tourism. And there are financial and technical justifications for state sales of motor vehicle registrations and state print shop operations.

On the other hand, we found little justification for state employees to provide nursing home care or routine computer programming and systems analysis. Neither type of service is in short supply, both are costly, and the state employees have no major role in fulfilling their departments' other goals.

In general, we think that all agencies should pay more attention to the costs and benefits of their programs and services and use objective information to make decisions about the best, most efficient delivery methods. We recognize that it may be difficult to make necessary changes, but it can also be costly to pursue the same objectives regardless of technology, the marketplace, and public preferences.

## RECOMMENDATIONS

As noted, the state's process for reviewing and approving professional/technical contracts is inefficient. It wastes reviewers' time and encourages state managers to break the law by allowing work to begin before contracts are legally valid. During our study, the program managers suggested two major ways to improve the process. First, they favored training for themselves, along with better written instructions. Second, they wished for exceptions and increased autonomy. Basically, we endorse these ideas.

To improve the process, we recommend that:

- **Contract reviewers from the Attorney General's Office and Departments of Administration and Finance should meet, define their joint and separate responsibilities, and develop a shared data base.**

In addition, we think that the Department of Employee Relations, which has recently begun to review some agencies' plans to hire consultants for training sessions, should consult with the primary contract reviewers to avoid further duplication. Ultimately, the shared data base could inform all agencies of the status of specific contracts while providing better information in the future.

We also recommend that:

- **The Legislature should amend *Minn. Stat.* §16B.17 to require prior approval only for contracts above \$10,000 (the median contract amount), not \$5,000.**

State law  
should be  
amended and  
operating  
procedures  
streamlined.

Although the 1990 Legislature only recently raised the dollar limit from \$2,000 to \$5,000, the change was not based on data such as we developed for this study. If the law were changed so that agencies obtained prior approval before writing contracts over the \$10,000 median, we think that the review and approval process would be more efficient and better focused. The Department of Administration would process approval requests only for the larger half of all professional/technical contracts, yet in fiscal year 1990 this would have covered 99 percent of the total estimated costs.

We also recommend some technical changes in the same statute, also concerning prior approval for larger contracts. For example, the language should clearly state that agencies must demonstrate that they tried but could not obtain needed services from existing state employees or previous contracts. Further, in requesting prior approval before writing larger contracts, state agencies should certify that they will not allow contractors to begin work before funds are officially encumbered. Such an addition could help to reduce the number of delays due to reviewers' unfounded suspicions that work could have begun already. Also, it might discourage agencies from allowing early starts as they do now on occasion.

In our opinion, the problem of delayed approval could also be reduced by changes in the Department of Administration's operating procedures. First:

- **The Department of Administration should prioritize its review and approval efforts by considering each contract's schedule, estimated cost, degree of risk, and substance.**

Top priority would go to costly contracts for complex professional/technical services, especially where services must be delivered according to strict deadlines.

We also recommend that:

- **The Department of Administration should delegate some of its specific responsibility to selected, qualified staff within agencies which have demonstrated that they know and have followed all necessary procedures in the past.**

The Attorney General's Office already has delegated some of its responsibility to selected individuals, up to specified dollar limits, and the Department of Finance is planning similar actions. To make this type of limited, specific delegation successful, the Department of Administration would need to use its data to analyze agencies' performance, but we think this could be accomplished without significant investment of resources.

In addition, the department should use its annual plan policy more effectively.

- **The Department of Administration should officially raise the dollar limit on annual plans for minor professional/technical services from \$500 to \$5,000 per contractor.**

This could reduce the number of contracts to be reviewed by about a third, and the \$5,000 limit already is an approved practice for one agency. We see little need for the full review and approval process for so many small contracts, provided that agencies follow the same procedures as contract reviewers would enforce, and the Department of Administration carefully reviews the annual plans before granting approval.

We also recommend that:

- **The Department of Administration should provide regular training and an up-to-date manual for project managers who are responsible for professional/technical contracts.**

Although the department has assigned half of one fulltime equivalent employee to answer specific questions, some of this time could be used to provide group instruction and improve the department's written manual of policies and procedures. At the same time, in updating the current manual, we think that:

- **The Department of Administration should develop better guidelines to help agencies determine when contracts might be appropriate or inappropriate.**

Finally, we think that agencies should keep track of what their services or programs cost. If they did, they could routinely compare the monetary and non-monetary costs and benefits of obtaining services through various mechanisms, which could lead to greater efficiency in state operations. However, without such basic information, we see little reason to expect that increased reliance on contracts or other alternatives alone could transform state government.

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# INTRODUCTION

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**The state's financial problems have renewed policymakers' interest in contracting.**

**L**ike most states, Minnesota is experiencing serious financial problems and, as a result, is exploring alternative ways to run state government and deliver public services. One possibility is to turn to the private sector for help, as local units of government have done for years. Thus, a recent survey indicates that many states (71 percent) expect to write more service contracts, mainly because of the potential for cost savings.<sup>1</sup>

Minnesota policymakers have become keenly interested in contracting for four main reasons. First is the claim that contracting would be more cost-effective than for the state to deliver services itself. This claim is especially appealing when state employees lack specific expertise, large capital investments would be needed, or new programs or services would generate significant start-up costs. Data show that state employees generally are paid more for similar jobs than private sector employees, and the number of state workers has increased.<sup>2</sup>

Second, contracting may be administratively or politically expedient. State agencies may use contractors interchangeably with state employees for a variety of reasons, including convenience, uncertainty about budgets and workloads, and custom. Sometimes, state government requires the objectivity that an outside contractor can bring.

Third, contracts may be a useful tool to improve management or productivity. For example, some agencies may use contractors alongside state employees to upgrade their workforce, use private sector techniques, or modernize state practices. At times, agencies may use contractors to help them price their own services and promote cost-efficiency.<sup>3</sup>

Finally, contracts are appealing to some because they could reduce the size or scope of state government while promoting nonstate businesses and institutions. For the private sector, contracts may help to offset some of the burdens

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<sup>1</sup> See Touche Ross & Company, *State Government Privatization in America* (Washington, D.C., 1989).

<sup>2</sup> According to a special analysis of survey data on state and private job classes with at least ten employees by the Department of Jobs and Training, private workers were paid 20 percent less overall than state workers in 1990. According to the Department of Employee Relations, the number of fulltime state employees rose from 23,749 in fiscal year 1985 to 25,647 in fiscal year 1991.

<sup>3</sup> Ted Kolderie, "Two Different Concepts of Privatization," *Public Administration Review* (July/August 1986): 285-290.

state government otherwise places on business. Contracts can support and encourage economic development efforts and help to support public educational institutions.

On the other hand, government contracting can be an invitation to corruption and abuse. Without proper controls and safeguards, agencies could award contracts unfairly and sacrifice the public interest for private gain. For these reasons, the Legislative Audit Commission asked us to evaluate professional/technical contracts. Our study addressed these key questions:

- **How much do state agencies spend on contracts for professional/technical services? Why do they hire contractors, and are they satisfied?**
- **What process must state agencies follow when contracting? How long does it take, and how could the process be improved?**
- **Do nonstate employees provide some public services more conveniently and economically than state employees? What are the costs and benefits of providing services through state employees versus alternatives?**

We used four basic methods to answer these questions. First, we analyzed financial information on all fiscal year 1990 professional/technical contracts by state agencies and, for a large sample, classified what type of work was to be performed.<sup>4</sup> Second, we conducted in-depth interviews with program managers from 18 major state agencies regarding recent contracts. Third, we interviewed staff who are responsible for reviewing and approving professional/technical contracts and studied contracting procedures. Fourth, we analyzed six cases where state government is providing services which are also available on the open market. In addition, we reviewed relevant legislation and corresponded with selected contractors and trade groups.

Our evaluation suggests that increased contracting will not automatically reduce government expenses and materially improve government services. We found that state agencies already contract for a wide variety of services in Minnesota, and contracts often provide ongoing services. But state managers sometimes have serious difficulties controlling contractors despite the state's rigorous, though inefficient, procedures for review and approval.

Our evaluation is presented in the following four chapters. Chapter 1 discusses the nature and extent of contracting in Minnesota. Chapter 2 examines the review and approval process for contracting and makes recommendations for improvement. Chapter 3 identifies and compares the costs and benefits of some state services which are available elsewhere. Finally, Chapter 4 synthesizes our research and presents some overall conclusions.

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<sup>4</sup> Fiscal year 1990 data were the most recent available at the time of our evaluation.

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# CONTRACTING BY STATE AGENCIES

## Chapter 1

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**F**or many years, state government has routinely contracted with the private sector and smaller units of government to provide some public services. Now, policymakers are asking whether state agencies could reduce expenses and improve public services by increased use of contracting, particularly with the private sector. At all levels of government, there is great interest in government contracting for professional/technical services.

This chapter examines the nature and extent of contracting which has occurred recently in Minnesota. We asked the following questions:

- **How much do state agencies spend on contracts for professional/technical services? What type of services do the agencies receive?**
- **Why do state agencies hire contractors? Are the agencies satisfied with contractors' performance? What problems have the contracts posed, if any?**

As we show in the following sections, agencies contract for a wide variety of professional/technical services, and usually they are pleased with the results. On the other hand, they have complaints about the state's procedures for contract review and approval, and we found some reasons to be concerned about agencies' contract management practices.

## DEFINITIONS

State law draws a distinction between contracts for consultant versus professional and technical services.<sup>1</sup> Although both are for intellectual services, not supplies or materials, the products are slightly different. Consultant contracts are presumed to result in a final report. Professional and technical service contracts must result in a completed task.

In practice, we found that the formal legal distinction has little meaning, and state agencies use the shorthand term "professional/technical" to describe contracts for various services, including consultants. Therefore, we use this term

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<sup>1</sup> *Minn.Stat.* §16B.17, Subd. 1(a)(b).

**Professional/  
technical  
contracts cover  
a range of  
intellectual  
products, from  
computer  
software to  
highway  
construction.**

to refer broadly to consultant, professional, technical, and computer-related services, as well as construction projects and miscellaneous activities.

The term "contract" refers to a written instrument containing the legal elements of offer, acceptance, and consideration to which a state agency is party.<sup>2</sup> Our study focused on 2,922 state contracts which the Department of Administration approved during fiscal year 1990, the most recent complete source of data when our study began. We excluded contracts for commodity purchases (previously studied by our office), leases and capital projects (recently studied by the executive branch), and contracts which originated from the Community College System, State Board of Technical Colleges, and the State University System.<sup>3</sup> We also excluded municipal projects except that city, county, and regional governing units sometimes serve as contractors to state agencies.

Throughout our report, "agency" refers to boards, commissions, authorities, or departments of state government. Generally speaking, the laws regarding professional/technical contracts apply only to agencies of the executive branch of state government.<sup>4</sup> However, some bodies such as the Supreme Court choose to follow many of the same procedures, while a few agencies such as the State Lottery have exemptions.

## EXPENDITURES

The statewide accounting system shows rapid growth in expenditures for three major categories of professional/technical contracts (Figure 1.1). In total, the three types of professional/technical services, excluding construction, cost about \$96 million during fiscal year 1987. In 1991, state agencies spent about \$175 million for the same categories of services. This represents an 83 percent overall increase during the five-year period compared with an increase of only about 20 percent due to inflation during the same period.

The Department of Finance has changed some of its categories over time, making it hard to determine the exact level of earlier spending for the same services. But the 1978 report of the Governor's Commission on Waste and Mismanagement showed a 99 percent increase in expenditures for similar types of contracts between 1974 and 1977, when expenditures rose from \$20 million to nearly \$40 million.<sup>5</sup>

<sup>2</sup> Minn. Stat. §16B.01, Subd. 4.

<sup>3</sup> See Office of the Legislative Auditor, *State Purchasing* (April 1982), *Procurement Set Asides* (February 1982) and *Follow-Up Study* (April 1985), *State Office Space Management and Leasing* (November 1981), and Department of Administration, *Report to the Legislature on Policies and Costs of Leasing Space Versus Constructing New Buildings to House State Agencies* (March 1988) and *State Office Space: Options and Costs* (December 1988).

<sup>4</sup> See Minn. Stat. §16B.01, Subd. 2.

<sup>5</sup> See *Governor's Cost Savings Program: Final Report by the Governor's Task Force on Waste and Mismanagement*, December 19, 1978, Appendix O (memo from Robert E. Goff, Director, to Governor Rudy Perpich, May 11, 1978), Exhibit 4, unpaginated.

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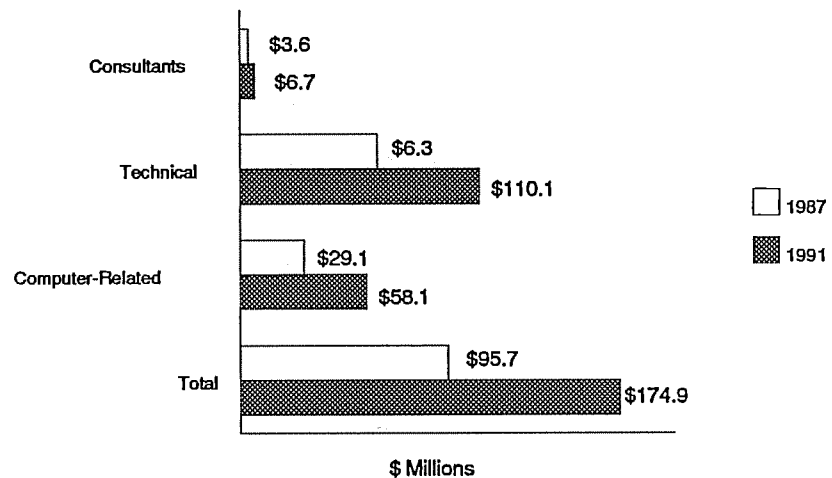
## ERRATUM

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On page 5, Figure 1.1, the bar depicting 1987 expenditures for technical contracts is incorrectly labeled \$6.3. The label should be \$63.0.



Figure 1.1: Expenditures for Three Types of Contracts, FY 1987-91



Source: Department of Finance.

The state does not record the number of professional/technical contracts which it makes each year, and existing records are of limited use for describing the purpose of expenditures under contracts. Thus, an important part of our study was to count recent professional/technical contracts and describe what state agencies received.

First, we tried to determine how much state agencies spent for particular professional/technical service contracts. However, it was impossible to determine state agencies' expenditures per contract even for fiscal year 1990. Many contracts from previous fiscal years are still effective, and agencies expect them to continue for several more years. Also, agencies often amend their contracts, increasing or decreasing the estimated cost, and agencies sometimes do not actually use any of the services for which they write contracts. In addition, the state lacks a management information system which could readily track expenditures over the life of professional/technical contracts.

Next, we tried to determine the number of professional/technical contractors and how much they were paid, but it was impossible to identify each one with certainty. The statewide accounting system records all payments to contractors, but multiple payments to the same firm or individual are often recorded as if they were different firms or individuals. A different spelling or abbreviation of a name triggers a separate listing. Also, the Department of Finance requires separate listings to pay branches of the same firm at various locations. In addition, contractors phase out businesses over time and open new ones.

Despite these difficulties, we could determine how much the contracts initially were expected to cost. Records show that:

**The total cost per contract may not be known for years.**

- Expenditures of nearly half a billion dollars (\$495,878,978) in professional/technical contracts were approved during fiscal year 1990.

This total is based on the broad definition of professional/technical contracts which we adopted for this study. Actually, most (78 percent) of the total was attributable to construction projects in the Department of Transportation, mostly highways and bridges. For purposes of analysis, Table 1.1 shows totals for these contracts separately from other contracts.

As shown, the median cost for the Department of Transportation's construction contracts was \$135,515 compared with \$10,000 for all state agencies. Several of the transportation contracts exceeded \$5 million. The largest was nearly \$68 million, to build the intersection of Trunk Highway 100 and Interstate 394.

**Table 1.1: Professional/Technical Contracts by Agency**

Agency	Contracts		Estimated Dollars	
	Number	Percent of Total	Total	Median
Administration	235	8%	\$14,219,534	\$16,000
Administrative Hearings	28	1	1,345,700	51,000
Agriculture	93	3	1,708,937	8,000
Arts Education Center	43	1	387,598	2,292
Arts Board	43	1	406,853	1,200
Corrections	229	8	10,320,910	7,020
Education	151	5	8,722,217	4,100
Employee Relations	23	1	1,342,905	17,000
Finance	5	<1	233,245	46,000
Health	78	3	1,759,419	7,184
Human Services	300	10	7,755,556	8,790
Iron Range Resources and Rehabilitation Board	42	1	474,735	4,000
Jobs and Training	122	4	2,111,946	5,005
Labor and Industry	17	1	129,812	3,000
Natural Resources	197	7	6,855,266	6,200
Planning	44	2	412,855	4,950
Pollution Control	72	2	7,849,517	38,275
Public Safety	69	2	1,979,758	4,170
Public Service	32	1	215,958	2,750
Revenue	48	2	8,407,890	8,100
Supreme Court	32	1	1,088,623	3,250
Trade and Economic Development	120	4	6,062,906	8,000
Transportation - Construction	509	17	384,520,955	135,515
Transportation - Other	189	6	24,039,402	20,000
Remaining Agencies	201	7	3,526,482	7,800
<b>Total</b>	<b>2,922</b>	<b>100%<sup>a</sup></b>	<b>\$495,878,978<sup>a</sup></b>	<b>\$10,000</b>

Source: Department of Administration, fiscal year 1990.

<sup>a</sup>Figures do not total exactly due to rounding.

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**The  
Department of  
Transportation  
wrote the most,  
and the largest,  
contracts.**

Overall, the Department of Transportation was the biggest source of professional/technical contracts in fiscal year 1990. The department generated nearly one-fourth of all the contracts. The Department of Human Services was the second largest contracting agency with 300 professional/technical contracts, many for health care services. However, these contracts tended to be small (median \$8,790) and represented only about two percent of the estimated total value of professional/technical contracts in fiscal year 1990.

Six other agencies wrote 100 to 200 contracts each and, together with the Departments of Transportation and Human Services, accounted for 70 percent of all the professional/technical contracts which the Department of Administration approved in 1990. In order of the number of contracts approved, the six other major agencies were the Departments of Administration, Corrections, Natural Resources, Education, Jobs and Training, and Trade and Economic Development.

Small contracts account for a large part of the volume handled by the Department of Administration. Table 1.2 shows that:

- **About one-fourth of the professional/technical contracts were for small amounts, estimated at \$3,000 or less.**

The smallest contract in fiscal year 1990 was \$80, to provide an artwork. Examples of other small contracts, valued at less than \$1,000, were to collect and identify mosquitoes, provide organ music, proctor an examination, and do a conference presentation.

The Department of Administration has a policy which allows state agencies to get blanket, annual approval for small payments to individuals or firms for most professional/technical services.<sup>6</sup> But the table shows that:

- **The Department of Administration formally reviewed numerous small contracts.**

Two percent of the professional/technical contracts were expected to cost less than \$500. For 14 percent, the estimated cost was less than \$2,000 each, and the value for one-third was below \$5,000. Formal approval may have been unnecessary in some of these cases, but staff explained that they do not want to confuse or discourage agencies from following formal procedures, regardless of the estimated cost of particular contracts. Also, they indicated a desire to accommodate agencies which, in effect, request the Department of Administration's approval as an extra measure of security.

Table 1.2 also shows how much the Department of Transportation's construction contracts affect the overall totals. Excluding the construction projects, the median value of professional/technical contracts fell to \$7,560 instead of \$10,000. The 75th percentile dropped to \$29,136 instead of \$51,000, and the

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<sup>6</sup> Technically, the policy precludes blanket approval for consultant contracts, but these were only six percent of the total.

**Table 1.2: Distribution of Estimated Expenditures for Professional/Technical Contracts**

Percentile	All Contracts (N = 2,922)	Excluding Transportation- Construction (N = 2,413)
5th	\$ 1,000	\$ 900
10th	1,500	1,280
15th	2,000	1,861
20th	2,400	2,000
25th	3,000	2,500
30th	4,000	3,000
35th	5,000	3,788
40th	6,700	5,000
45th	9,000	6,000
50th (median)	10,000	7,560
55th	14,600	9,642
60th	20,000	10,880
65th	29,098	15,000
70th	40,000	20,000
75th	51,000	29,136
80th	77,777	40,000
85th	125,000	51,000
90th	235,819	88,447
95th	521,877	200,000
Lowest	80	80
Highest	67,889,897	6,000,000
Average	169,705	46,149
Total	\$495,878,978	\$111,358,023

Source: Department of Administration, fiscal year 1990.

largest professional/technical contract was \$6 million instead of nearly \$68 million.

## TYPE OF CONTRACTS

State law requires the Commissioner of Administration to describe professional/technical contracts in monthly and quarterly reports to the Governor and Legislature.<sup>7</sup> However, we found that:

- The department has not produced quarterly, summary reports--only partial, monthly listings of professional/technical contracts which it has approved, and none which it has disapproved.

<sup>7</sup> Minn. Stat. §16B.17, Subd. 4. Minn. Laws (1991), Chapter 345, Article 1, Section 20, Subd. 4 added that money spent on outside consultants must be reported annually to the Senate Finance and House Appropriations Committees.

We reviewed several of the monthly listings, each of which is about ten pages long. The listings include the following information by department for some but not all contracts plus amendments to earlier contracts: (1) the contractor's name, (2) a narrative description of the project, (3) the estimated dollar amount, (4) the beginning date, and (5) the ending date. The listings exclude costly transportation construction contracts which are a major portion of the professional/technical staff's responsibilities, plus a few others.

The only summary information we found in the monthly listings was the total estimated cost and the subtotal for each department. But this information could be misleading: the totals and subtotals combine the estimated cost of new contracts with additions and subtractions to the estimated cost of old ones.

The law does not state specifically that the Legislative Reference Library should be a repository for the Legislature's reports, but the library has received the monthly reports for many years and made them available on request through a separate filing system.<sup>8</sup> The library staff told us last fall that the reports had not been cataloged but may be in the future.

## Classification Method

We designed our own system to classify each contract since the Department of Administration's narrative descriptions were not standardized. This accomplished two objectives simultaneously. First, our system indicated what each contract was mainly to provide: (1) goods and services; (2) research and opinions; (3) training and instruction; or (4) miscellaneous activities. Second, the classification system indicated each contract's subject matter, such as art, architecture, computer systems, finance, and health care.

Examples of contracts for "goods and services" included the production of a video program, service as an expert witness, medical and chemical testing, appraisals, and software maintenance. To be in this category, contracts mainly had to produce something tangible or deliver a direct service such as a physical examination.

Contracts which provided "research and opinions" included a computer needs study, consultation on security, evaluation of a grant application, review of quality assurance mechanisms, and examination of bridge plans. By definition, contracts in this category were primarily to analyze something that agencies already had developed, received, or provided.

"Training and instruction" contracts were those that required at least one formally conducted session such as a lesson or demonstration, or the production of formal educational materials. For example, farm tours, first aid classes, stress management instruction, conferences, and a diabetic drivers' manual went into this category.

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<sup>8</sup> At least one reporter has regularly read and published information from the monthly contract listings in a newsletter, the *Government Reporter*.

Our preliminary review of the Department of Administration's narrative descriptions indicated that some of these were sufficient to systematically classify contracts but, in other cases, it would be necessary for us find and reread many, often complex documents.<sup>9</sup> Therefore, we classified only a sample (39 percent) of the professional/technical contracts which the department had approved.<sup>10</sup>

## Results

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**State agencies most frequently contracted for direct services or tangible goods.**

As shown in Table 1.3, nearly two-thirds of the contracts (64 percent) were for goods and services. Twenty-two percent were for research and opinions, 10 percent were for training and instruction, and four percent were for miscellaneous items, including musical entertainment.

Looking at the results by agency, the table reveals that most agencies wrote some of all three basic types of professional/technical contracts. However, for two agencies, the contracts were entirely for goods and services. For example, all of the Department of Transportation's construction contracts were to produce something tangible, usually highways and bridges.

Other agencies relied heavily on professional/technical contracts to provide research and opinions. We classified nearly half (48 percent) of the Department of Agriculture's contracts as research and opinions which, in many cases, meant crop and livestock surveys and advice to financially troubled farmers from farm advocates.

Other agencies used professional/technical contracts extensively for training and instruction. Nearly half (48 percent) of the Department of Revenue's fiscal year 1990 contracts fell into this category. Such contracts entailed workshops, seminars, and classes on topics such as communication, cultural diversity, ethics, and problem solving.

While categorizing the general purpose of professional/technical contracts, we also classified the contracts' subject matter. As shown by Table 1.4, state agencies obtained diverse services through professional/technical contracts in fiscal year 1990. Looking at all the professional/technical contracts regardless of the contracting agency, the results again showed that the most common purpose was construction, in this case including building operations, real estate, and construction of all kinds (23 percent of the contracts and 78 percent of the estimated costs). The second most common subject was health care of all kinds (19 percent), including psychiatry, chemical dependency treatment, veterinary

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<sup>9</sup> We requested copies of contracts first from the Department of Administration and, when those were missing, from the Department of Finance. *Minn. Stat.* §16B.06, Subd. 2, requires the Department of Finance to keep a copy of every contract which extends for at least a year. The Department of Administration also keeps copies of most contracts for reference purposes.

<sup>10</sup> This particular percentage resulted from our decision to classify at least a representative, sizable group of contracts from each of the agencies listed in Table 1.1. For each of the agencies with numerous contracts, we randomly selected 52, which was at least ten percent of the total. Later, for analysis, we weighted these agencies' results to estimate the total number of professional/technical contracts which they wrote.

**Table 1.3: Type of Professional/Technical Contracts by Agency**

<u>Agency</u>	<u>Goods and Services</u>	<u>Research and Opinions</u>	<u>Training Classes</u>	<u>Other</u>
Administration	83%	10%	8%	0%
Administrative Hearings	100	0	0	0
Agriculture	35	48	17	0
Arts Education Center	26	33	12	30
Arts Board	74	26	0	0
Corrections	83	6	10	2
Education	31	44	15	10
Employee Relations	61	4	35	0
Finance	20	80	0	0
Health	54	36	8	3
Human Services	64	29	8	0
Iron Range Resources and Rehabilitation Board	31	10	0	60
Jobs and Training	23	64	8	6
Labor and Industry	12	47	35	6
Natural Resources	37	42	10	12
Planning	55	25	14	7
Pollution Control	42	49	9	0
Public Safety	45	15	38	3
Public Service	72	13	16	0
Revenue	42	6	48	4
Supreme Court	41	22	38	0
Trade and Economic Development	71	4	8	17
Transportation - Construction	100	0	0	0
Transportation - Other	62	17	17	4
Remaining Agencies	<u>57</u>	<u>29</u>	<u>12</u>	<u>2</u>
Total	64%	22%	10%	4%

Source: Sample of 1,147 contracts approved by the Department of Administration, fiscal year 1990.

**Table 1.4: Subjects of Professional/Technical Contracts**

	<u>Percent of Contracts</u>	<u>Percent of Total Estimated Value</u>
Advertising and Communications	7%	2%
Art and Graphics	5	<1
Architecture and Engineering	6	5
Building Operations, Real Estate, and Construction	23	78
Law Enforcement and Security	3	1
Clerical and Data Processing Services	2	2
Computer Information Systems	6	3
Environmental, Agriculture, and Science	10	3
Rules, Law, and History	4	1
Management and Finance	6	1
Health Care	19	3
Personnel	3	<1
Live Entertainment	2	<1
Other	<u>4</u>	<u>&lt;1</u>
Total	100%	100%

Source: Sample of 1,147 contracts approved by the Department of Administration, fiscal year 1990.

services, and medical tests, representing about three percent of the estimated costs. The third most common subject of professional/technical contracts (10 percent) included environmental, agricultural, and scientific projects.

Seven percent of the contracts concerned advertising and communications, and six percent each were for computer information systems, management and finance, and architecture and engineering. No other subject captured more than five percent of the professional/technical contracts.

## RELATIONSHIP BETWEEN STATE AGENCIES AND CONTRACTORS

To learn more about how state agencies use and manage professional/technical contracts, we conducted in-depth interviews and reviewed paperwork for 36 of the 1,147 randomly selected contracts which we had classified. We focused on 18 major departments and for each reviewed the largest contract in our sample plus one medium-priced or typical professional/technical contract. Included were the Departments of Administration, Agriculture, Corrections, Human Services, Jobs and Training, Natural Resources, Employee Relations, Trade and Economic Development, Education, Finance, Labor and Industry, Transportation (construction and other), Pollution Control, Public Safety, Public Service, Health, and Revenue.

We read each of the 36 contracts, noted any amendments, and pulled relevant correspondence from files at the Department of Administration. Next, we collected information from the person who was named on each contract as the state's authorized administrator, that is, the program manager.<sup>11</sup> Subsequently, we scheduled an hour-long, structured interview with each of the program managers and other agency officials. Among other things, we asked about their departments' rationale for hiring particular contractors, competition for the contracts, potential alternatives, performance monitoring, and ways to improve contracting procedures. In some cases, we followed up with professional/technical contractors themselves and learned their perspective on similar issues.

## General Findings

Initially, the 36 contracts in our in-depth study were estimated to cost about \$19 million. Program managers determined that the actual expenditures for the contracts amounted to nearly \$18 million as of June 30, 1991. At that

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<sup>11</sup> We asked program managers to complete a short questionnaire and send us selected documents including completed evaluation forms and work plans. Only 7 of the 36 program managers had completed a contract evaluation form before we asked. Partly, this was because the 1990 Legislature released the Department of Administration from a requirement to collect and retain an evaluation of each professional/technical contractor's performance for reference purposes. See *Minn. Laws* (1990), Chapter 572, Section 3, Subd. 4. Now, the department asks agencies to complete the evaluation form for internal use only.



time, half of the contracts cost less than \$52,000, with the most expensive about \$8 million.

In one case, the department never used its contract and paid nothing. Circumstances had changed, and there was no need for correction services for one individual. Work stopped abruptly on another contract when decision makers learned that it could lead to a high-priced building project. However, 16 of the 36 program managers were actively working with the contractors and expected that they would continue.

Many contractors had ongoing relationships with the state. Agencies had worked with the same contractors for an average of 5.5 years. In 8 of the 36 cases, program managers told us that the contractors had worked for their agency or other state agencies for at least 10 years. Sixteen years was the maximum, but, in nine cases, the contractors had worked for the state for two years or less.

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**Sometimes agencies treated contractors as if they were state employees.**

In several agencies, professional/technical contractors were so well integrated that they were hard to distinguish from state employees. One program manager said, "The only difference is they're not on the payroll." In fact:

- **About half of the program managers said that the professional/technical contracts provided some of their departments' ongoing tasks or services.**

Some of the contracts for ongoing services which we reviewed in depth were for data processing, psychiatric services, magazine production, and debt collection. As shown in Table 1.5, most of the remaining contracts were either to start a program or system, or to do a one-time project, event, or report. Some such contracts were to study the quality of care given to Medicaid recipients, provide landscaping, install a computer system, and conduct training sessions.

By a wide margin, the most common explanation for professional/technical contracts was to obtain special expertise. (See Table 1.6.) In 14 cases, program managers said that the contracts were at least partly the result of staff shortages. Eleven of the program managers indicated that the profes-

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**Table 1.5: Main Work to be Provided by Professional/Technical Contracts**

	<u>Number</u>
Ongoing tasks or services	17
Start-up of new or additional program or system	8
One-time or special project, event, or report	8
Other, unclassified	2

Source: Questionnaires from program managers for 35 of 36 selected contracts.

Note: The question was: "What type of work was this contract primarily intended to provide?"

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**Table 1.6: Major Reasons Why Agencies Wrote Professional/Technical Contracts**

	<u>Number</u>
Needed special expertise	26
Staff shortage	14
Traditional practice	11
Time constraints	6
Federal requirement	5
Legislative or executive request	5
Needed objective outsider	2
Other, unclassified	7

Source: Questionnaires from program managers for 35 of 36 selected contracts.

Note: The question was: "Which of these reasons describe why your department entered into this contract?" More than one reason could be marked.

sional/technical contracts were the customary way that services had been provided.

In other cases, professional/technical contracts originated from time constraints and external requirements. For example, a program manager told us that he would have preferred to administer a grant, but his agency's attorney said that a contract was necessary. As shown, program managers said that 10 of the 36 contracts resulted from federal, executive, or legislative directives.

## Contractors' Performance

**Most agencies were pleased with their contractors' performance and thought they got "a good deal."**

During interviews, we asked the program managers to rate their contractor's performance on a ten-point scale. Some (10 of 36) could not say, but:

- Most of the program managers rated their contractor's performance at least an 8 out of 10.

Six program managers gave their contractor a perfect 10, and 8 used the rating of 9. The lowest rating was 6 out of 10. Also, we tabulated the results of the Department of Administration's evaluation form received for all but four of the contracts and found that:

- Only one program manager said that the contractor's services were unsatisfactory.

On the form, all but four program managers indicated that the contractors accomplished the objectives in the specified time, and all but two said they would engage the contractor's services again. In addition, during our interviews, program managers spoke positively about their experiences with contractors.

Typically, the program managers indicated that the contracts represented "a good deal" for the state. For example, one told us that his department could never attract someone else to do the same amount and quality of work for the same amount of money.<sup>12</sup> According to this program manager, the department's relationship with the contractor was "extraordinary," and it was like "paying for a clerk and getting an executive." The program manager added that this contractor not only performed like a department employee but supervised other employees and completed their performance evaluations. However, according to the program manager, it was better for the department to contract for the work than to hire a state employee because the contract lends an air of objectivity to the results.

Another program manager told us that his department was able to pay contractors about half the going rate because they could count on the state for (1) prompt, full payment and (2) secure positions which were not available in the private sector. One described the state as a "prize" account for contractors. He said that, on the average, he got two calls a week from prospective new contractors.

For a different agency, we learned that a contract with a nationally respected firm yielded nonmonetary benefits. According to the program manager, the firm gave the department "access to the world" and helped set higher standards for health service delivery in Minnesota. She added that she learned much that her department could use by accompanying the contractor in the course of its work.

While they maintained highly positive relationships, we observed that the program managers usually seemed to exert adequate control over their contractors. They usually could explain their supervisory activities in detail. Moreover, if problems occurred with individual contract workers' performance, several managers told us that they could have the workers replaced.

In general, professional/technical contracts gave state managers a welcome measure of freedom from routine personnel issues. Also, in light of fluctuations in work flow and uncertainty about budgets, the program managers were glad for the opportunity to contract for services on a time-limited basis although they seldom canceled contracts and often extended them.

## State Performance

Most program managers we interviewed (26 of 36) were critical of the state's procedures for contract review and approval.<sup>13</sup> The biggest problem was that:

- The process took so long that in some cases agencies violated the law by allowing contractors to begin work before contracts were valid.

<sup>12</sup> The contract paid about \$44,000 for one individual to work halftime.

<sup>13</sup> We explain the procedures in detail in Chapter 2.

*Minn. Stat.* §16A.15, Subd. 3 states that employees are subject to removal if they knowingly incur an obligation or authorize expenditures before contracts are approved and funds encumbered by the Department of Finance.

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**Agencies often criticized the contract review and approval process.**

Despite the law, program managers explained that it sometimes made economic sense to let contractors begin before contracts were final. One offered this rationale: (1) He believed it would save money to get started sooner; (2) inflationary increases otherwise would affect the cost of materials and labor; and (3) a delay in processing could have amounted to a year's delay in completing the project. We learned that delays are particularly troublesome for construction contractors. Often, their projects can only be completed during fair weather. In any event, agencies were hard pressed to keep major construction firms waiting for signatures when workers and machinery stood idle. In one extreme case, an agency official told us that his department gave the go-ahead to a contractor last summer, and all of the necessary road resurfacing was done before the contract was finally approved.

Other program managers told us they made contractors wait for final approval but lost as much as six weeks of productivity as a result. One claimed that she started the paperwork in April or May and was lucky if contracts were final in August. Another said that it is terribly inconvenient to discontinue services while waiting for paperwork to get through the process.

To avoid contractors working without valid contracts, a program manager told us that he hand-carried half of all his professional/technical contracts to the Department of Administration although he realized this was not an efficient use of his time. Another said that since the approval process took so long, his contractor simply "learned to live with" providing services for which the state would later pay.

Some managers were frustrated by the contract review and approval process because they saw little or no value in it. During our interviews, they questioned the need for signatures from the Attorney General and Departments of Administration and Finance since contracts often amount to standard forms ("boilerplate"), and signatories often use a stamp to mark their approval on copies. We found that:

- To more than one agency, the contract review and approval process appeared to be mere "rubber-stamping," pointless paper-shuffling, or bureaucracy at its worst.

The program managers suggested two basic ways to improve the process. First, they favored training for themselves, along with better written instructions. Second, they wished for exceptions and increased autonomy. In Chapter 2, we evaluate the program managers' claims and recommend ways to improve the process of contract review and approval.

## QUESTIONABLE CASES

Although most program managers were pleased with contractors' performance and reported only minor difficulties managing the work, there were a few exceptions. In this section, we explain the most important problems, based on program managers' comments during structured interviews.

For the 36 contracts studied, we identified several potential problems which are listed in Table 1.7. For example, we noted the lack of competition in each case where managers indicated that their agencies chose not to publicize the need for services. When program managers mentioned that they had trouble making their needs known to contractors, we counted that as an example of weak control. We also noted each case in which program managers remarked that: the contract could have cost more than alternatives; the quality or quantity of contractors' work was less than expected; and other state agencies could have helped to avoid the need for the contract. In addition, we noted those cases where program managers suggested a potential conflict of interest which put contractors in a position to benefit beyond the terms of the contract.

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**Table 1.7: Concerns Raised by Selected Professional/Technical Contracts**

	<u>Number</u>
Lack of competition	17
Weak controls	11
Costs may have been higher than alternatives	8
Inter-department problems contributed to the decision to write a contract	6
Questionable quality or quantity of work	5
Possible conflict of interest	2

Source: Analysis of interviews with program managers for 36 contracts. Interviews sometimes raised more than one concern.

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Some of our concerns resemble those which have been raised in recent audits.<sup>14</sup> The program managers shared some of the same concerns themselves but, in other cases, they did not register an opinion. Our assessment came later and was designed to illustrate real and potential problems for policymakers' information.

Based on all 36 interviews, we concluded that:

- Only a few contracts had several serious problems.

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<sup>14</sup> See memos from Ronald W. Gipp, Audit Director, Department of Transportation to Commissioner John H. Riley and Deputy Commissioner Edwin H. Cohoon, August 16 and 20, 1991, and to Commissioner James N. Denn and Deputy Commissioner Edwin H. Cohoon, January 3, 1992, Department of Administration, *Board of Medical Practice Licensing and Discipline Information System*, November 26, 1991, and Office of the Legislative Auditor, *Annual Reports, 1986-90*.

Perhaps by now the problems we observed have been resolved, but the examples below illustrate program managers' worst difficulties with specific contracts:

1. At the time of our interview, one program manager stated that her department had reached "detente" with its contractor after "go-rounds" with the second of two managers. She told us that the project completion date had been moved from February to December 1991, that contract workers had almost completely disregarded the department's vision of a computer system, and occasionally the contractor submitted work that did not meet requirements. The agency had paid about \$88,000 of the contract's estimated total cost of \$280,000. The program manager added that state employees had to help the contract workers, who were not as skilled technically as she would have liked, and the project was much bigger than the department or the contractor anticipated.
2. Another state agency paid a contractor about \$130,000 over three years for statistical studies but found that help was not readily available when needed. The out-of-state contractor visited with the program manager once a month, but she indicated to us that sometimes she did not know what to ask to clarify her concerns because the project was too technical. She and another agency official questioned whether the contracting firm was adequately staffed. They said it had been difficult to track the contractor's progress, but they expected improvement since asking for more detailed, written work reports and invoices rather than verbal progress reports.

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**About half the time there was no competition for contracts.**

Below, we discuss more general concerns which the interviews raised. Again, program managers may have subsequently resolved some problems.

First, we found that competition for the contracts occurred only about half the time. According to two program managers, their contracts went without publicity partly because they had bad experiences with previous vendors. One explained that his department did not advertise a \$45,000 contract to test-grow potatoes because (1) few others besides the existing contractor would be interested, (2) the cost was reasonable, and (3) the previous contractor's performance was disastrous.

In two other cases, program managers indicated that the Department of Administration ultimately stepped in and insisted that state agencies publicly request proposals if they planned to contract again for the same service. In a third case, agency officials told us that they realized they made a mistake by not allowing any other contractor to submit a proposal. The Department of Administration had excused the agency from advertising when it claimed that the selected contractor was the only choice, but in reality, agency officials neglected to consider all the options. If the project continues, they told us that the contract will be publicized.

Second, in 11 cases, interviews suggested that state agencies sometimes exercised weak control over contractors' activities. In one such case, an agency originally asked contractors to propose as much work as they could for \$2 million. According to the program manager, this way, the review committee would not have to select the lowest bidder for any given set of required services. In another case, a program manager told us that her department exercised adequate control over its contractor even if it meant "yelling, screaming, and hollering." She gave the contractor a 3 on a ten-point scale for its administrative performance but a 7 for overall performance, explaining that the department suffered through several changes of contact persons and late reports.

Third, program managers indicated that the cost of services through contracts, including administration, may have been higher than alternatives in eight cases. However, some pointed out that the extra costs were unavoidable because they could not hire additional state employees to do the work. One explained that physicians prefer to run their own practices, and another said that he could not get money for additional staff positions.

Our fourth concern was that some contracts stemmed from problems between state agencies. For example, one program manager explained that his agency had to hire computer programmers under contract because it had purchased a particular type of computer which the Department of Administration did not support. Another manager said that the Department of Employee Relations lacked the staff and financial resources to provide quality training classes, so it used a contractor instead.

In five cases, program managers indicated that the quality or quantity of contractors' work had a negative effect on state projects. One such case involved a contractor who operated a messy waste-handling facility, which the agency had to close for two weeks while the contractor cleaned up. In another case, the manager said that contract workers developed an expertise with his project over time. He said the contractor's approach could have been better, and that its methodology was "not the greatest or the fastest," but his agency was happy with the results.

Finally, we were concerned about the potential for conflict of interest in two cases. In one of these, a program manager told us that her department made it very clear to a contractor that future hardware purchases were contingent on getting a good price for a software development contract. The department advertised the contract but received only one proposal, from the hardware manufacturer. A second case involved a former state employee. While still on the job as a parttime employee, we learned that she had her own consulting business and proposed to work for her department as a consultant. After leaving state employment, she worked for the department for about two years. During that time, the program manager added that the contractor had a better intellectual grasp of the Commissioner's goals than the department's own employees.

## SUMMARY

Our study showed that state agencies mainly use professional/technical contracts to obtain goods and services such as road construction, health care, and technical reports. The contracts also provided research and opinions and training classes and instruction.

Our interviews with 36 program managers about selected large-to-medium contracts revealed that almost all of them were satisfied with contractors' performance. Their main concern was with the state's procedures for contract review and approval, but we had some concerns about contract management. In Chapter 2, we explain the state's procedures and guidelines for contract review and approval, describe reviewers' activities, and discuss some reasons why the program managers may experience delays.



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# CONTRACT REVIEW AND APPROVAL

## Chapter 2

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**A**s we discussed in Chapter 1, professional/technical contracts can be costly and hard to control. We found reason to question the way in which some state agencies have selected and managed contractors. Yet, aside from such administrative problems, state agencies often depend upon contractors to provide some of their ongoing services as well as special expertise.

This chapter examines the process of contracting. We asked the following questions:

- What process do agencies follow when contracting? How long does it take? What guidelines does the state provide to program managers?
- Who reviews professional/technical contracts? What problems have they uncovered? Is their time well spent?
- How could the state improve the contract review and approval process? Could agencies help to reduce processing delays?

This chapter is divided into three major sections. First, we describe the steps, procedures, and guidelines for professional/technical contracts. Second, we explain the functions which are performed by contract reviewers in the Attorney General's Office and Departments of Finance and Administration. Finally, we recommend changes which we think could significantly improve the process.

## CONTRACT REVIEW AND APPROVAL

In 1976, the Governor created the Office of Contract Management partly to control and reduce agencies' expenditures for professional/technical contracts.<sup>1</sup> Essentially, *Minn. Laws* (1978), Chapter 480, formalized the Governor's executive order. Since then, the Office of Contract Management has

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<sup>1</sup> Our history of the Office of Contract Management is based on the *Governor's Cost Savings Program: Final Report by the Governor's Task Force on Waste and Mismanagement*, December 19, 1978, Appendix O (memo from Robert E. Goff, Director, to Governor Rudy Perpich, May 11, 1978).

been dismantled, but many of its activities continue as before through the Materials Management Division of the Department of Administration.

## Procedures

With few exceptions, procedures for professional/technical contracts are outlined in law.<sup>2</sup> Figure 2.1 describes the steps that most professional/technical contracts must go through before they become legally valid. As shown:

- State agencies are responsible for most steps in the contract review and approval process.

**Figure 2.1: Professional/Technical Contract Review and Approval Procedures**

<u>Responsible Party</u>		<u>Step</u>	<u>Objective</u>
<u>Agency</u>	<u>Others</u>		
Program Director		1	Determine the need for contractual service and a. If the estimated amount is \$5,000 or less, proceed to Step 7. b. If the estimated amount is over \$5,000, proceed to Step 2.
		2	Request prior approval by completing a certification form and forwarding it to the division director.
Division Director		3	Review the certification form, approve or disapprove the proposed contract, obtain oral approval of the agency head, sign the certification form, and send to the assistant commissioner for signature.
Contract Coordinator		4	Review the certification form and send two copies to the Department of Administration along with a copy of the Request for Proposal (RFP), proposal evaluation form, and direct mail list of firms to be sent the RFP.
	Department of Administration	5	Approve, disapprove, or modify the certification form, and a. If approved, sign the form and return both copies to the agency. b. If disapproved or modified, return the form to the agency and explain.
Program Manager		6	In cooperation with the assistant commissioner or division director, provide public notice, arrange for a selection committee, and take part in the selection and final negotiation process with the contractor.
		7	Write the contract.
Accountant		8	Code accounting information onto the contract.
		9	Requisition funds from the state accounting system.
Contract Coordinator		10	Remove carbons, keep one copy, and send remaining copies to the contractor for signature.

<sup>2</sup> Minn.Stat. §16B.17.

**Figure 2.1: Professional/Technical Contract Review and Approval Procedures, continued**

<u>Responsible Party</u>		<u>Step</u>	<u>Objective</u>
<u>Agency</u>	<u>Others</u>		
	Contractor	11	Review the contract, sign each copy, and return all copies to the agency.
Assistant Commissioner		12	Sign each copy and return to contract coordinator.
Contract Coordinator		13	Send the signed contract and, when applicable, one copy of the certification form to the agency Attorney General.
	Agency Attorney General	14	Review the contract for form and execution and a. If approved, sign each copy and send to the contract coordinator. b. If not approved, return to the agency for corrections.
Contract Coordinator		15	Log in the contract number, date, and send to the Department of Administration.
	Department of Administration	16	Review the contract and a. If approved, sign each copy, retain a copy, and forward the remainder to the Department of Finance. b. If not approved, complete a contract return form, explain, and send all copies of the contract to the agency for corrections.
	Department of Finance	17	Review the contract and a. If approved, encumber funds, retain the original for permanent files, and send the remainder to the contract coordinator. b. If not approved, return to the agency for corrections.
Contract Coordinator		18	Forward one copy to the agency accountant and two copies to the program manager.
Program Manager		19	Send a copy to the contractor.
	Contractor	20	Begin work after receiving a fully executed copy of the contract.
Program Manager		21	When the contract has been completed, evaluate performance and file a copy of the report, when required, with the Legislative Reference Library.

First, program managers and directors determine whether they need professional/technical services from contractors and how much the services will probably cost. Next, for contracts over \$5,000, they must develop a request for proposals, find potential contractors, and get approval from agency executives as well as the Department of Administration. If approval is granted, agencies are responsible for selecting one specific contractor, writing the contract, and requisitioning the necessary funds. When the agency is satisfied that all is in order, the contractor signs, and then an assistant commissioner. At that point, professional/technical contracts leave the agency for external review

again by the Department of Administration plus the Attorney General's Office and Department of Finance before finally returning for implementation if approved. The law states that agencies are fully responsible for diligent administration and monitoring.<sup>3</sup>

As we mentioned in Chapter 1, agencies sometimes have difficulty specifying precisely what professional/technical services should accomplish. Months may pass before a satisfactory legal contract finally emerges and meets with a contractor's specific approval. Therefore, when agencies send professional/technical contracts for external review and approval, they are typically under time pressure to complete needed work. We think this pressure exacerbates agencies' natural impatience with the time it would take anyone for a thorough review and decision whether to approve contracts. As Figure 2.1 implies:

- **The professional/technical contracting process is inherently complicated and time-consuming.**

For example, Step 5 alone (prior approval by the Department of Administration) takes at least three days for most proposed contracts, and if publicity is required as in Step 6, contractors must have at least three weeks to respond.

For the Department of Human Services, which maintains detailed data on the approval process, we found that it took an average of 15 days last year to get contractors' and agency heads' signatures (Steps 11 and 12), including mailing time. The agency attorney general's review and approval took an average of about four days (Step 14). After that, the Departments of Finance and Administration each took an average of 5 or 6 days, respectively (Steps 16 and 17).<sup>4</sup>

Staff at the Department of Administration cautioned that Steps 16 and 17 can take longer than a few weeks. They explained that there are two major reasons for delays: (1) a glut of work during the summer, and (2) the quality of agencies' work in preparing professional/technical contracts.

As shown in Figure 2.2, the department received its biggest monthly volume of professional/technical contracts during the summer, when one fiscal year ended and a new one began on July 1. The Department of Administration has had a backlog of as much as 15 working days during the summer. The Department of Finance told us that its processing can take five to six days in the peak period compared with three to four days at other times.

Nevertheless, records indicated that:

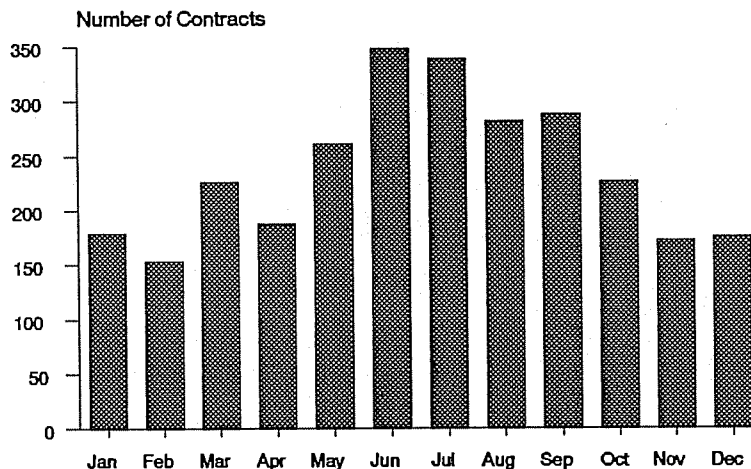
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<sup>3</sup> *Minn. Stat.* §16B.06, Subd. 3.

<sup>4</sup> We also checked data from a manual system at the Department of Transportation and found that Steps 16 and 17 took about 17 days, including mailing time. Because these two agencies handle the greatest numbers of contracts, they have specialized staff who expedite the contract review, approval, and transmission process. Processing is likely to take longer elsewhere unless agency representatives walk contracts through the process in person. When contracts are walked or rushed through, Steps 16 and 17 may be completed in a day or two.

**The Department of Administration's workload is heaviest when the fiscal years begin and end.**

**Figure 2.2: Contracts Sent to the Department of Administration by Month**



Source: Department of Administration, 1990.

- **The Department of Administration has approved half of all professional/technical contracts within four days.**

One reason for the results shown in Table 2.1 is that the department approved 11 percent of the contracts on the same day as they were received. In other words, these were rushed or walked through. Another 18 percent were approved one day after receipt, and they too may have received special handling. Conversely, eight percent of the department's approvals took ten days or longer.<sup>5</sup>

However, during the 1990 fiscal year:

- **The Department of Administration returned ten percent of all professional/technical contracts for revisions or further information before granting approval.**

The return rate varied widely by agency, as shown in Table 2.2. The return rate was less than five percent for the Office of Administrative Hearings, the Supreme Court, Iron Range Resources and Rehabilitation Board, and Departments of Human Services, Education, and Transportation (construction). On the other hand, staff returned a high proportion of contracts from their own department and others.

<sup>5</sup> Our statistics are based only on contracts which were ultimately approved. The Department of Administration has no specific information concerning contracts it returned and agencies subsequently dropped. However, based on the number of contracts which lacked approval dates, we estimate that the maximum rate of attrition was eight percent.

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**Table 2.1: Median Days from Receipt of Contract to Approval by the Department of Administration**


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<u>Agency</u>	
Administration	0
Administrative Hearings	2.0
Agriculture	2.0
Arts Education Center	3.0
Arts Board	5.0
Corrections	5.0
Education	4.0
Employee Relations <sup>a</sup>	6.0
Finance <sup>a</sup>	13.0
Health	5.0
Human Services	4.0
Iron Range Resources and Rehabilitation Board	2.0
Jobs and Training	3.0
Labor and Industry <sup>a</sup>	14.0
Natural Resources	3.0
Planning	3.0
Pollution Control	3.0
Public Safety	3.0
Public Service	3.0
Revenue	3.0
Supreme Court	5.5
Trade and Economic Development	3.0
Transportation - Construction	4.0
Transportation - Other	4.0
Remaining Agencies	3.0
Total	4.0

Source: Department of Administration, fiscal year 1990.

<sup>a</sup>These agencies had fewer than 25 contracts in total for the year.

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### **Some delays are agencies' own fault.**

In most cases, when contracts went back to agencies for revisions or further information, the data show that the Department of Administration's approval took a total of at least two weeks. We analyzed the reasons why the Department of Administration returned contracts to agencies, and the results are shown in Table 2.3. The Department of Finance had similar records for fiscal year 1991, when it returned two percent of the contracts, and those results are shown in Table 2.4.

In a considerable number of cases, the tables suggest that:

- **Agencies could have avoided some processing delays if they had paid closer attention to detail.**

For example, agencies could have ensured that contracts were properly signed, and they could have transmitted the required number of copies. In other cases,

**Table 2.2: Contracts Returned to Agencies by the Department of Administration**

<u>Agency</u>	<u>Percent of Total</u>	<u>Median Days Between Return and Re-receipt</u>
Administration	17%	8.0
Administrative Hearings	0	--
Agriculture	13	11.5
Arts Education Center	7	6.0
Arts Board	16	5.0
Corrections	7	7.0
Education	4	8.0
Employee Relations <sup>a</sup>	30	3.0
Finance <sup>a</sup>	60	7.0
Health	14	7.0
Human Services	3	2.5
Iron Range Resources and Rehabilitation Board	2	6.0
Jobs and Training	13	6.0
Labor and Industry <sup>a</sup>	65	9.0
Natural Resources	9	6.0
Planning	32	2.5
Pollution Control	11	9.5
Public Safety	14	15.0
Public Service	9	5.0
Revenue	10	8.0
Supreme Court	3	8.0
Trade and Economic Development	11	5.0
Transportation - Construction	2	3.0
Transportation - Other	14	5.5
Remaining Agencies	22	10.0
Total	10%	7.0

Source: Department of Administration, fiscal year 1990.

<sup>a</sup>These agencies had fewer than 25 contracts in total for the year.

**Table 2.3: Major Reasons Why the Department of Administration Returned Contracts to State Agencies**

	<u>Percent of Contracts Returned</u>
Suspicion that work began before money was set aside for payment	41%
Missing or unclear accounting information	21
Missing form requesting prior approval that work is appropriate for professional/technical contract	18
Missing signature(s) on contract or initials for changes	18
Missing or unclear payment information	10
Missing copies or original contract	5
Missing, mislabeled, or unreferenced attachments	5
Should have been advertised	4

Source: Department of Administration, fiscal year 1990.

Note: Percentages total more than 100 because some contracts were returned for multiple reasons.

**Table 2.4: Major Reasons Why the Department of Finance Returned Contracts to State Agencies**

	Percent of Contracts Returned
Missing signature(s)	38%
Missing explanation and/or signature on explanation why work may have begun before money was set aside for payment	25
Missing or inaccurate accounting information	15
Missing identification number to pay contractor, requisition, and/or encumbrance request form	8
Insufficient funds	3
Missing or unclear payment information	3

Source: Department of Finance, fiscal year 1991.

agencies could have done a better job of explaining payment methods and attachments to their contracts. However, in our opinion:

- **The most common cause of contract delays--uncertainty over the date that work would begin--is not always the fault of the agency writing the contract.**

**It is difficult  
for reviewers to  
tell when  
contracts  
effectively  
begin.**

As we explained earlier, program managers sometimes have compelling reasons for allowing contractors to begin work early, and the review and approval process itself may be partly to blame. But whatever the reason, since an early start could violate the law, both the Departments of Administration and Finance scrutinize the anticipated effective date of professional/technical contracts and demand a written explanation when they see that it has passed.<sup>6</sup> But contracts do not indicate when or if work actually began, so agencies sometimes are wrongly suspected of violating procedures.

We reviewed correspondence which indicated that some departments disregarded their contracts' anticipated effective date while waiting for the Departments of Administration and Finance to sign off. Also, some program managers indicated that they refused to allow work to begin early.

In other cases, we think that program managers may not have been fully aware that they had skirted procedures. This also could explain why the Department of Administration had to tell some agencies that they needed to advertise and obtain prior approval before writing some contracts.<sup>7</sup>

<sup>6</sup> In financial audits, our office has stressed to both departments that *Minn. Stat.* §16A.15, Subd. 3 states that obligations may not be incurred unless the Commissioner of Finance has certified a sufficient unencumbered balance in the fund, allotment, or appropriation. Only one explanation is requested, to the Department of Finance.

<sup>7</sup> Subdivisions 2 and 3 of *Minn. Stat.* §16B.17 currently require prior approval, also known as certification, for contracts over \$5,000.



## Prior Approval

For contracts over \$5,000, the law states that agencies must complete a detailed approval request form and obtain the Commissioner of Administration's signature before selecting contractors and writing contracts. Among other things, agency officials must give the assurances shown in Figure 2.3 and explain how or if they notified the public about the availability of the contract. Steps 3 through 5 of Figure 2.1 further describe the certification process.<sup>8</sup>

**Contracts over \$5,000 must now go through a prior approval process.**

### Figure 2.3: Agency Assurances for Contracts Over \$5,000

1. There is no state employee (a) capable and (b) available to perform the described service.
2. Competitive bidding will not provide for adequate performance of the service.
3. The service is not available as the product of a prior contract, and the contractor will certify his product will be original in character.
4. Reasonable efforts will be made to publicize the availability of the contract. Public notice will be made as follows (explain).
5. A written work plan will be submitted by the contractor and accepted by the agency.
6. The following person has been assigned to monitor and act as liaison for the contract (fill in).
7. There will be periodic review of the progress of the contractor, and the final product will be utilized.
8. The contract will not establish an employer/employee relationship between the state or the agency and any person performing under the contract.
9. No current state employee will engage in the performance of the contract.

Source: Department of Administration form CD-00065-02.

We obtained and analyzed computerized data reflecting all prior approval requests for the agencies in our study during fiscal year 1990.<sup>9</sup> The results showed that:

- The Department of Administration required agencies to resubmit four percent of their requests for prior approval, and it sent another one percent of the requests out for specialized review.

<sup>8</sup> *Minn.Laws* (1991), Chapter 345, Article 1, Section 20, Subd. 4, also gave the Department of Employee Relations responsibility to ensure that state agencies demonstrate that they cannot use available staff before hiring outside consultants or services.

<sup>9</sup> In all, the agencies generated 1,396 forms.

Staff have no systematic information on the reasons why they returned or referred the prior approval request forms to others, but they told us that the main problem was lack of publicity. Fifty-five percent of the forms claimed that competitive bidding would not result in adequate services.

In addition, the computerized log of approval requests shows whether the forms arrived before the finished contracts, as the law requires. These data suggest that some agencies short-circuited the process because:

- **One-fourth of the prior approval requests arrived at the same time as the contracts themselves.**

Similarly, according to the Department of Administration, the *State Register* last year published some requests for proposals before the Commissioner approved the proposed contracts. Staff sent a reminder memo to agency contract administrators in May 1991, stressing that requests for proposals must be approved before they appear in the *State Register*.<sup>10</sup>

## Training

We asked agency officials and administrators how program managers learn the procedures they should follow for professional/technical contracts. We also reviewed manuals, memos, and forms, and visited a training session that one state agency recently held for its own employees.

The Department of Administration has no regularly scheduled formal training sessions on professional/technical contracts, but staff give occasional presentations, answer many questions by telephone, and provide agencies with an official manual of policies and procedures. However, we found that:

- **The official manual is out of date, incomplete, and sometimes inaccurate.**

To compensate, the Department of Administration has sent occasional memos to about 30 contract coordinators (usually one per agency). Some departments nevertheless have their own manuals which clarify, correct, and sometimes supersede the official manual. For example, the Department of Health requires program managers to follow the full set of procedures for contracts over \$3,000 instead of \$5,000.

In some cases, staff at the Department of Administration told us that they have recommended the Department of Human Services' policy and procedures manual in addition to their own. Our examination of the Department of Human Services' manual showed that it is easier to use and more current than the official manual. Most notably, the human services manual clearly illustrates that the state's requirements become increasingly rigorous as contracts' estimated value increases.

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**Most state managers lack training and up-to-date information on contracting procedures.**

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<sup>10</sup> Memo from Gerald T. Joyce, Department of Administration, to Agency Contract Administrators, May 22, 1991.

Figure 2.4 summarizes the special requirements for small and large professional/technical contracts. These apply progressively as contracts reach the following levels: \$5,000 or less, over \$5,000, over \$10,000, over \$50,000, and over \$100,000. As shown, agencies need only to get the Department of Administration's general approval once a year for the smallest class of contracts, but they must satisfy multiple legal requirements when contracts exceed \$100,000.

**Figure 2.4: Special Requirements for Small and Large Professional/Technical Contracts**

<u>Estimated Cost</u>	<u>Special Requirements</u>	<u>Related Requirements</u>
\$5,000 or less per contractor per fiscal year	Get Administration's authorization for annual plan, then skip the formal approval process.	Technically, not for consultants.
Over \$5,000	Certify to Administration that the contract complies with <i>Minn. Stat. §16B.17</i> , subd. 3, and define steps to publicize.	Administration must agree that the contract complies with <i>Minn. Stat. §16B.17</i> , subd. 2.
Over \$10,000	Certify to Administration intention to publicize request for proposal (RFP) in State Register.	Mail RFP to potential contractors and run notices in other publications.
Over \$50,000	Obtain certificate of affirmative action plan compliance from the Department of Human Rights if the contractor has more than 20 fulltime employees.	If the contractor has no more than 20 fulltime employees, obtain a waiver from the Department of Human Rights or notarized statement.
Over \$100,000	Require prime contractor to subcontract a portion of the contract to economically disadvantaged small businesses.	Submit a quarterly report to Administration, listing contracts with economically disadvantaged small businesses, and set aside some of the annual value of professional, technical, and consulting contracts for such businesses.

The department's policy of granting general approval for agencies to be responsible for their own small contracts dates from the late 1970s, when the Office of Contract Management initially developed its procedures. Staff realized that they could spend an inordinate amount of time reviewing paperwork for small, routine professional/technical services to the detriment of large, complex contracts. To increase the efficiency of its work, the office developed an "annual plan" policy in consultation with the Department of Finance.

## Annual Plans

According to the official manual, agencies should write annual plans in memo form. They should justify their various needs for minor professional/technical services and state that no firm or individual will receive more than \$500 from the agency over the entire fiscal year.<sup>11</sup> Then, the plan must be signed by an agency assistant commissioner, approved by the Department of Administration, and filed at the Department of Finance.

During the year, agencies work out their own arrangements with contractors whose services are approved under annual plans. For certain services such as couriers, agencies might simply require invoices. The Department of Transportation has small contractors sign an agreement form which resembles a purchase order. In other instances, agencies might prefer to write contracts, but they would not need external review and approval.

We reviewed agencies' annual plans for fiscal year 1990 and found that they covered a wide variety of services, similar to those we described for professional/technical contracts in general. In total:

- **We calculated that state agencies got the Department of Administration's approval to spend nearly \$11 million for professional/technical services through annual plans.**

The results showed that a few agencies received permission to spend several hundred thousand dollars for professional/technical services in small amounts during the year. Also:

- **The Department of Administration has approved as much as \$2,000 per firm or individual through annual plan memos and as much as \$5,000 for one agency.**

Staff explained that the actual maximum for annual plans is determined on a case-by-case basis, depending on the agency, circumstances, and written justification.<sup>12</sup>

## Policies and Procedures

Another problem with the Department of Administration's policy and procedures manual is that it leaves out important legislative changes which occurred after it was published in February 1990. Most importantly:

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<sup>11</sup> Department of Administration, *Policies and Procedures Manual: Consultant, Professional, and Technical Services Contracts* (February 1, 1990), 13.

<sup>12</sup> See memo from Gerald T. Joyce, Department of Administration, to Agency Contract Personnel, July 20, 1990.

- **The official manual states that agencies must obtain prior approval before writing contracts over \$2,000 although the 1990 Legislature raised the limit to \$5,000.**

The 1990 Legislature dropped another requirement, but:

- **The official manual nevertheless states that agencies should send an evaluation report to the Department of Administration.**

The department itself asked the Legislature for amendments to allow these procedural changes. Its first goal was to reduce the number of contracts which required certification. Second, staff wanted to stop trying to collect completed evaluation forms from agencies because they had very little success.

We learned that other errors in the manual occurred because staff (1) inadvertently reprinted a reference to legislation which was repealed after the Office of Contract Management was originally established, (2) neglected to revise language to reflect 1989 legislation and rules on economically disadvantaged small businesses, and (3) later added a new requirement, in a memo, that state agencies should send the Department of Administration a copy of their proposed selection form along with requests for proposals.

## Guidelines

In a national survey by the U.S. General Accounting Office, Minnesota was found to be the only state to provide state agencies with some guidance as to activities that would be inappropriate for government contractors.<sup>13</sup> The guidelines state that contracts should not be written to:

1. evade position control restrictions, salary limitations, or competitive employment procedures,
2. engage individuals or firms to represent a state agency in a legislative matter,
3. make policy or management decisions,
4. obtain the services of craft, service, or office workers, or
5. obtain materials or supplies.

Despite the General Accounting Office's praise, the impact of these guidelines is unknown. As we explained in Chapter 1, state agencies often turn to contract workers because of staff shortages and rely upon contractors partly because it frees them from personnel management issues. Also, we found at

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<sup>13</sup> U.S. Government Accounting Office, *Government Contractors: Are Service Contractors Performing Inherently Governmental Functions?* (Washington, November 1991), 29. Twenty-five states made other types of suggestions, and 12 states gave agencies no guidance or only very general guidance. Twelve other states did not respond.

least one contractor who managed a staff of state employees and another who was to lobby the Wisconsin Legislature on behalf of a Minnesota state agency. In addition, we read several professional/technical contracts for secretarial, graphic design, and janitorial services, which the Department of Administration has worked to discourage.

We also noted that the manual attempts to explain how the Department of Administration determines whether contracts amount to employer/employee relationships which are prohibited by law. For example, it uses these guidelines among others:

1. Contractors' services must be offered and available to the public and only incidentally to the state.
2. Services must be offered to the state as a part of contractors' regular professional occupation and self-employment.
3. Contractors must not perform services on state premises, use state equipment or supplies, or be assisted by state employees except under special circumstances.

Despite the department's guidance, we question whether state agencies fully appreciate the distinction between contractors and employees. Several program managers told us that the two types of workers were interchangeable, and the Department of Administration has acknowledged that contractors often are assigned offices, computers, telephones, and the like.

## CONTRACT REVIEWERS

*Minn. Stat.* §16B.06 says that state contracts are not valid until approved in writing by the Commissioner of Administration, the Attorney General, and the Commissioner of Finance. The Department of Administration has overall responsibility for contract management and review. The Attorney General's main responsibility is to see that contracts are consistent with legal requirements. The Commissioner of Finance is primarily responsible to see that agencies have set aside or encumbered sufficient money to cover the contract in full.<sup>14</sup>

We interviewed contract reviewers and their supervisors in all three of these agencies to determine how they do their work and how the review and approval process could be improved. In addition, we observed reviewers during

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<sup>14</sup> In addition, *Minn. Stat.* §43A.21 requires the Commissioner of Employee Relations to approve agencies' plans to provide general management or supervisory training. In making its appropriation to the Department of Employee Relations, the 1991 Legislature specified that the department should approve general management training, whether provided in-house or by consultants, and restated the requirement that state agencies must demonstrate that they cannot use available staff before hiring outside consultants or services. See *Minn. Laws* (1991), Chapter 345, Article 1, Section 20, Subd. 4 and 6.

on-site visits and discussed some new, additional procedures with the Department of Employee Relations.

## Department of Administration

Our interviews revealed that state agencies wait for contracts to be reviewed and approved partly because:

- **The Department of Administration has assigned too little staff to review professional/technical contracts.**

**Department of Administration staff must review a staggering number of contracts, among other items.**

Only one contract administrator and one documents assistant handle about 3,000 professional/technical contracts annually, along with approximately 9,000 other important documents. Besides the professional/technical contracts, the two staff are responsible for reviewing grants, loans, interagency agreements, nonmonetary contracts, income or receivable agreements, annual plans, requests for prior approval of larger contracts, and amendments to previous contracts. The contract administrator who is primarily responsible for professional/technical contracts spends about one-fourth of his time reviewing contracts of various kinds. He told us that about half of his time is spent answering specific questions and requests for help from agencies. During the rest of his time, he reviews requests for proposals as part of the process of approving larger contracts in advance.

The administrator explained that his goal is to review and decide whether to approve professional/technical contracts within three or four days, but this is not always possible.<sup>15</sup> Neither he nor the documents assistant has a regularly assigned back-up to handle contracts during vacations and illnesses, and they have no extra help during the peak summer period. In fact, when we visited the contract administrator's office on several occasions last fall, a backlog of six to seven stacks (days) of contracts awaited his attention.

Although the documents assistant logs the contracts and approval requests into computerized data bases, we noted that the Department of Administration has rarely used the computerized information to help make decisions or manage its workload. Despite the fact that data are available (for example, as in Tables 2.1 and 2.2):

- **The Department of Administration does not systematically compile information on the number and value of professional/technical contracts by year, the actual length of time it takes to review the contracts, the number or type of contracts received from agencies, or the problems that caused the department to return some agencies' contracts more than others.**

Staff emphasized that they would like to do a better job, but they lack even the time to thoroughly read and review contracts.

<sup>15</sup> Table 2.1 confirms that he approved half the contracts in four days or less during fiscal year 1990.

The contract administrator said that he thought state agencies appreciated the contract review and approval process, particularly when large expenditures were anticipated. He indicated that he exercises little or no authority over the agencies' contracts, even when they seem ill advised or overly expensive. Rather than disapprove such contracts, he said he typically puts the documents aside and asks additional, detailed questions. Likewise, when agencies on occasion try to circumvent the required steps and procedures, the administrator told us that he sometimes raises the requirements for contract approval.

## Attorney General's Office

The Attorney General assigns one or more attorneys to help each state agency with specialized legal matters. As a result, many different attorneys sign agency contracts, and they follow somewhat different procedures, depending on their specialty. Technically, the attorneys are to determine whether contracts are legal in form and execution, but sometimes, they also advise and train agency staff on a variety of contract issues. They may write entirely new contract language or simply sign standard contract forms.

We spoke with attorneys and a paralegal assistant who are responsible for signing contracts for several of the major state agencies, including the Departments of Transportation, Administration, Education, and Natural Resources. They explained that their level of involvement varies with the experience and training of agency staff and the substance of proposed contracts.

In 1987, the Legislature enacted *Minn. Stat.* §8.20 so that the Attorney General's Office could delegate some of its specific responsibility to selected, qualified agency staff. Thus, in several agencies, contract coordinators now have the Attorney General's formal permission to sign standard professional/technical contracts for themselves, up to a certain dollar limit (usually \$25,000 but ranging from \$2,000 to \$2,500,000). In other agencies, attorneys told us that they would like to but cannot delegate their responsibility to agency staff. In such cases, they said staff work with contracts only occasionally, so they lack the necessary background and experience. On the other hand, we learned that some agencies have shied away from attorneys' attempts to delegate their authority for, as we explain below, legal reviews can be complicated.

According to the Attorney General's Office, it favored delegating some of its responsibility to specific individuals within state agencies mainly as a way to improve the efficiency of state government. The agency attorneys saw little value in repeatedly reviewing the state's standard contract form, especially since their colleagues wrote it originally, or in reviewing contracts which they personally had developed for their agencies' general use. Another reason why they requested delegation power was that it has become more difficult to sign agencies' contracts from a logistical perspective. Most of the Attorney General's staff have been moved out of the agencies they serve.



In reviewing contracts for form and execution, we learned that some attorneys follow checklists which cover as many as 10 pages. They look to see whether signatures are real, in ink, by lawfully delegated authorities, by the correct corporate officers, in the proper form, with attachments properly incorporated, payment terms specified, and any handwritten, typed, or white-out changes initialed by the signers. They ascertain that the state agency has the statutory authority to enter into the contract and that the state can legally enter into all terms of the contract. In addition, the attorneys review applicable statutes, depending on the subject and services to be provided. For example, they determine whether contracts should contain clauses concerning prevailing wages, workers' compensation, copyright, voter registration, and affirmative action.

Attorneys' tasks could be simplified somewhat if the Department of Administration would routinely update and distribute the state's standard contract form (Number 1051). The current form is legal- rather than letter-size and contains five sheets of carbon paper which must be torn out and reversed to complete both sides of the document. Also:

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**Outdated  
contract forms  
add work and  
further delays.**

- **Agencies sometimes have used outdated contract forms which lacked legal clauses that have become standard.**

Among the 36 contracts we studied in depth from fiscal year 1990, the oldest standard form was dated 1982. Last fall, the Department of Administration distributed a contract form that was dated 1985 although the form had been revised and reprinted in 1987 and 1990.

When an agency uses one of the outdated forms, attorneys must often write and attach the missing clauses. If that is not done, the Department of Administration returns the contract if the missing clauses are necessary. However, to avoid such problems, some agencies have put the current, correct, standard contract language on a computer diskette and distributed copies for staff use. This also eliminates the messy carbon paper.

## **Department of Finance**

At the Department of Finance, staff check to see whether the agency has requisitioned the necessary funds before the contractor's signature (Steps 8 and 9 of Figure 2.1). Next, they look for signatures from all four parties which should precede theirs: the contractor, agency, Attorney General, and Department of Administration. Third, they examine the effective date to see whether it has already passed. Finally, finance staff verify that agencies have set aside the full, correct amount of the contract, from the correct fiscal year or years, and have coded the anticipated expenditure correctly within the statewide accounting system. Assuming that contracts pass these initial hurdles, the next step is to enter the agencies' encumbrance requests into the statewide accounting system for overnight processing.

Because the Department of Finance processes encumbrance requests along with other financial transactions once daily, agencies must wait at least one

day for verification that they have the money to make their contracts legally valid and effective. On occasion, as we showed in Table 2.4, the Department of Finance returns contracts because of insufficient funds, unclear information, and other problems.

**On a pilot basis, the Department of Finance has delegated some of its contract approval authority.**

Staff indicated to us that, like the Attorney General's Office, they have already found some ways to increase the efficiency of the contract review and approval process. For example, they resolve some minor technical difficulties on their own. Second, they adopted a new policy last year to prevent contracts from being returned to agencies when the only problem was a missing identification number for the contractor. Third, staff told us they were actively working with one agency on procedures which would ultimately allow them to delegate their authority to one specific, qualified staff member on a pilot basis. If the pilot project is successful and other agencies also demonstrate that they have the necessary internal procedures, the Department of Finance may further delegate some of its power to specific staff within agencies, subject to monitoring.

In the meantime, staff expressed annoyance at having to process so many contracts for small dollar amounts. They pointed out that the value of multiple reviewers' time probably exceeds the face value of some contracts. Staff also questioned the need for reviewers outside the Department of Finance to check accounting and financial information on professional/technical contracts.<sup>16</sup> In addition, staff were concerned about the amount of time they spent trying to determine whether contractors actually had begun work before the necessary money was encumbered.

## Department of Employee Relations

At the Department of Employee Relations, staff have only recently written new procedures and informed state agencies that they must separately submit proposed training activities, both in-house and through contractors, to them for additional review and approval.<sup>17</sup> Although the law previously said that state agencies must get the department's approval for managerial or supervisory training, use of consultants was not mentioned specifically until 1991.

The Department of Employee Relations generally is responsible for training policies and, to the extent possible, training sessions for state employees. By law, its classes must promote individual, group, and agency efficiency and effectiveness.<sup>18</sup> Thus, the department routinely offers 18 different courses for all employees, and another 18 for managers and supervisors. As shown in Figure 2.5, courses which are open to all employees include Clear Writing and Effective Presentations. Courses for managers and supervisors include Dealing with Troubled Employees and Selection Interviewing. During fiscal year

<sup>16</sup> As Tables 2.3 and 2.4 suggest, some duplication of activity has occurred.

<sup>17</sup> See memo from Linda Barton, Commissioner of Employee Relations to Agency Heads, September 30, 1991.

<sup>18</sup> See *Minn. Stat.* §43A.21.

### Figure 2.5: Department of Employee Relations' Training Classes, July through December 1990

#### Courses for All Employees

Career Renewal  
 Clear Writing  
 Creating Satisfied Citizens and Customers  
 Defensive Driving  
 Effective Presentations  
 Listening  
 Making Meetings Work  
 Management Orientation for Non-Managers  
 Personal Time Management for Administrative Support Staff  
 Personal Time Management for Professional-Technical Staff  
 Pre-Retirement Planning  
 Preparing for Retirement  
 Preventing Sexual Harassment  
 Print Communication Services  
 Speech Building  
 Stress Management  
 Successful Communication: Getting the Message Across  
 Statewide Accounting System Overview for Accounting Personnel

#### Courses for Managers and Supervisors

Communicating About and Appraising Performance  
 Dealing with Troubled Employees  
 Ethics in Government; Ethics in Action  
 Handling Discipline and Grievances  
 Investigating Employee Misconduct  
 Management Development Core Program  
 Managing Employee Performance  
 Managing People: Preventing Sexual Harassment  
 Managing Sick Leave  
 Personal Time Management for Managers and Supervisors  
 Quad Seminars for Managers  
 Selecting Employees in a Union Environment  
 Selection Interviewing  
 Supervising for Safety  
 Supervision: Managing the Human Resource  
 Supervisory Core Program  
 SWAS Overview for Managers and Supervisors  
 The Three Rs of Ethics: Roles, Responsibilities and Resources

#### Courses for Instructors

Instructor Training

Note: Some Department of Employee Relations' classes are presented by staff from other state agencies.

1990, about 6,200 participants attended a total of 335 training sessions through the Department of Employee Relations.<sup>19</sup>

At the same time, in reviewing the Department of Administration's description of professional/technical contracts, we saw that:

- **Many agencies contracted for courses with titles similar to the Department of Employee Relations.**

The agencies' classes may have varied from the Department of Employee Relations' in terms of content, length, participation, and quality of instruction, but we also found that:

- **Only 22 percent of the Department of Employee Relations' training classes were filled to capacity.**

<sup>19</sup> This is a duplicated count; employees may have attended more than one session.

During fiscal year 1990, department records showed that enrollment averaged only 73 percent of capacity, and 13 percent of the classes which were offered, later were cancelled because of low or no enrollment.

Although most of the agencies' training contracts were small, with one-half estimated to cost no more than \$2,000, we estimated that the total cost amounted to about \$7 million. In addition, we found that:

- **Through agencies' annual plan memos, the Department of Administration approved another \$1 million for general training during fiscal year 1990.**

One million dollars is roughly equal to the entire biennial budget for the Training and Development Division of the Department of Employee Relations. Moreover:

- **The Attorney General's Office and the Departments of Administration and Finance have approved contracts for training classes with little involvement from the Department of Employee Relations.**

We found that the Department of Administration has directed one of its own divisions to review and approve training contracts.<sup>20</sup> This particular division, the Management Analysis Division, has no statutory authority over agencies' training activities but provides training for a fee which may be lower than state agencies could get from private contractors. Thus, the Department of Administration suggested that agencies should consider its Management Analysis Division as a substitute for contractors but, in its memo, did not mention the Department of Employee Relations as an alternative.

## Coordination

Overall, we found little reason to believe that reviewers simply were rubber-stamping professional/technical contracts as program managers suspected. On the contrary, we noted that the reviewers followed written procedures, consulted statutes, and carried out legal and professional duties. However:

- **Reviewers from the Attorney General's Office and Departments of Finance, Administration, and Employee Relations have not worked in coordination with each other.**

To some extent, duplication of activity may be useful because one signatory could catch errors that a previous reviewer had missed. Nevertheless, in our opinion:

- **Contract reviewers should meet, define their joint and separate responsibilities, and develop a shared data base.**

<sup>20</sup> Memo from Gerald Joyce, Department of Administration to Agency Contractor Coordinators, March 6, 1991.

**The Department of Employee Relations has not been routinely involved in the review and approval process.**

The data base could be used to inform agencies of the status of specific contracts while providing statistics and management information in the future.

## OTHER RECOMMENDATIONS

Based on our study, *Minn. Stat.* §16B.17 should be revised. For example, in seeking approval for contracts over \$5,000, the law requires agencies to certify to the Commissioner of Administration that no state employee is able to perform the proposed services and that the services are not already available as the product of a prior contract. However, we found that:

- **The state has no inventory of its employees' skills.**
- **A separate law makes the Department of Employee Relations responsible for some of the same duties.**
- **Only 16 percent of consultants' reports for fiscal year 1990 contracts were filed at the Legislature Reference Library last fall.**

Part of the reason for the scarcity of reports at the library is definitional. By law, consultant contracts are supposed to be those that result in a report, but agencies describe some contracts as consultant services when, in fact, the work is not intended to yield a public document. For example, one agency told us that it allows consultants to give oral rather than written reports.

In general, the legislative librarians said they had difficulty determining which contracts on the Department of Administration's monthly listings were expected to result in reports which should be in their collection. Even when reports were submitted to the library, it was hard to match the submissions with specific contracts. Also, we found that some reports still are pending for fiscal year 1990 contracts because the work is incomplete.

**State law should be amended and operating procedures improved.**

At the same time, the law prohibits contractors from providing state agencies with more than three copies of their written reports.<sup>21</sup> One of these copies is designated for the Legislative Reference Library, and only two are for the agency. Further, one of the agency's two copies is supposed to be in camera-ready form to allow for in-house printing or copying. This latter provision could add more time to the process of contracting, but we were told that it is often ignored.

Thus, in our opinion, *Minn. Stat.* §16B.17 could be improved by some technical changes which would drop the artificial distinction between types of professional/technical contracts, require agencies to demonstrate only once that they searched unsuccessfully for alternatives, and allow agencies to determine the most efficient way to get the necessary number of reports when needed.

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<sup>21</sup> *Minn. Stat.* §16B.17, Subd. 5.

In addition, we suggest that the statute could be amended to require state agencies to certify that they will not allow contractors to begin work before funds are encumbered for larger contracts. Added to the list of nine other assurances in Figure 2.3, which the law already requires, the added words could reduce some of the paperwork and delays related to reviewers' unfounded suspicions that work began before funds were set aside in the statewide accounting system.

To reduce the number of early starts which actually occur, we think that operating procedures should be changed at the Department of Administration, and:

- **The Legislature should amend Subdivision 3 of *Minn. Stat.* §16B.17 to require prior approval before writing contracts above the median value of \$10,000--not \$5,000.**

Although the Legislature only recently raised the dollar limit from \$2,000 to \$5,000, the change was not based on data such as we developed for this evaluation. If the law were changed so that agencies obtained prior approval before writing contracts over the \$10,000 median, the data suggest that the review and approval process would be more efficient and better focused. The Department of Administration would process approval request forms only for the larger half of all professional/technical contracts. In fiscal year 1990, this would have covered 99 percent of the total estimated costs.

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**The state  
should spend  
less time  
reviewing small  
contracts.**

To improve operating procedures at the Department of Administration, we recommend first that:

- **The department should officially raise the dollar limit on annual plans from \$500 to \$5,000 per contractor.**

This could reduce the number of contracts to be reviewed by about a third and is already an approved practice for one agency. In our opinion, all agencies can and should be primarily responsible for their own small, routine contracts with the Department of Administration's general approval. However, in executing even small contracts, they should continue to use the same sound procedures that external reviewers would otherwise apply.

Second, we think that:

- **The Department of Administration should provide regular training for project managers who are responsible for professional/technical contracts.**

As we mentioned in Chapter 1, several program managers told us that they wanted training. The Department of Administration currently has assigned about half of one fulltime equivalent employee to answer specific questions, but some of this time might be used more effectively for formal group instruction and improvements to the official manual, which we found was outdated.

**Some review and approval responsibilities should be delegated to good-performing agencies.**

Third, we recommend that:

- **The Department of Administration should prioritize its review and approval efforts by considering each contract's schedule, estimated cost, degree of risk, and substance.**

Top priority should go to large, non-routine contracts for complex professional/technical services. At the same time, the department should actively discourage state agencies from submitting small dollar contracts for full-scale review except in unusual cases. By generally reviewing contracts in chronological order, we think that staff have lengthened the processing time unnecessarily for some contracts.

In addition, we think that staff should adjust their procedures to reflect specific agencies' past performance and internal procedures. Rather than give every agency's contract the same general priority, we suggest that:

- **The department should delegate some of its specific responsibility to selected individuals within agencies, using guidelines such as those the Attorney General's Office has implemented and the Department of Finance is considering.**

To make this type of limited, specific delegation successful, the three agencies should make their guidelines as consistent as possible. For example, they might restrict delegated authority to standard contracts of less than \$25,000, depending on each agency's personnel and typical size and type of contracts.

## SUMMARY

In our opinion, the rationale behind the contract review and approval process is generally well founded. Contracts can be expensive and, even if small, can expose the state to significant risks. However, our evaluation shows that the process could be carried out with greater efficiency than is currently the case.

We made a number of suggestions which could help to improve the contract review and approval process. First, the Attorney General's Office and Departments of Administration, Finance, and Employee Relations should coordinate their efforts. Second, *Minn.Stat.* §16B.17 should be amended. Third, the Department of Administration should improve its manual, regularly provide training for program managers, allow agencies to take general responsibility for small, routine contracts, focus its efforts on the state's more expensive, challenging contracts, and delegate some of its authority to qualified individuals within state agencies. Also, we think that contracting agencies could help to improve the process and results of contracting by increased attention to their own practices.

In Chapter 3, we focus upon several cases where state employees, for various reasons, provide essentially the same services as nonstate employees. In light of program managers' general satisfaction with contractors, we ask why state agencies have chosen to deliver some of the same services as are available on the open market.



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# STATE WORKERS VERSUS ALTERNATIVES

## Chapter 3

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**M**innesota state agencies have long relied on the private sector and other units of government to deliver some professional/technical services through contracts. But the state has little systematic knowledge about the extent of this reliance, the reasons for it, and the alternatives. The Department of Administration's guidelines and listings of professional/technical contracts provide little insight into the costs and benefits of contracting.

This chapter identifies several functions of state government where contract workers have supplemented the work of state employees, or where the potential or desire for greater reliance on nonstate workers exists. Our research focused on these major questions:

- **What are some government functions where state employees provide services that are also available from the private sector or other units of government? In these cases, why does the state provide services itself?**
- **What are the costs and benefits of the state providing services with its own employees rather than through nonstate workers?**

This chapter is divided into two major sections. First, we present our criteria for selecting which state services to focus upon and discuss some other services which we examined in less detail. Second, we analyze the overall costs and benefits of state workers providing six different services which are simultaneously available on the open market: motor vehicle registrations, nursing homes, fish rearing, tree nurseries, printing, and routine computer programming and systems analysis.

## CRITERIA

As we showed in Chapter 1, state government has routinely used nonstate workers to obtain numerous, diverse services. Most notably, the state has relied on private construction companies to build roads and bridges for many years.<sup>1</sup> Likewise, the state traditionally has relied on others to provide health

<sup>1</sup> As early as 1909, Minnesota had its first laws concerning highway construction contracting.

care for its citizens. Yet, policymakers have done so with little systematic information on the overall costs and benefits of alternatives to state employees.

To analyze the costs and benefits of using state workers to deliver some services which are available on the open market, we used four criteria to help us select which services to study. Besides being simultaneously available from others, our criteria required that:

1. There should be adequate data to compare like services fully, fairly, and empirically.
2. Comparisons should involve large state agencies or activities that cut across different agencies.
3. Comparisons should cover a range of state activities from the concrete to the abstract, that is, tangible items as well as expert analysis.
4. The costs and benefits of state services should be defined both in monetary and nonmonetary terms.

Notably, our first criterion ruled out detailed study of some new, well known contractual services. For example, state park workers simply stopped taking camping and lodging reservations on site in 1990 when the Department of Natural Resources hired a California contractor to do the work centrally through a toll free telephone number. The department had no information on the amount of time state workers spent taking reservations but assumed that the contract would permit state employees to concentrate more intently on park activities while saving future park users from contacting various parks in search of vacancies. In another instance, the Legislature required the Minnesota Pollution Control Agency to contract for a new service, automobile emissions testing, which became necessary when carbon monoxide pollution in the seven-county metropolitan area exceeded federal guidelines.<sup>2</sup> The contractor began testing automobiles during the summer of 1991, with minimal involvement from state employees.

In other cases, we could not systematically compare some state and nonstate services because state agencies simply lacked adequate cost data. For example, the Department of Transportation ran a series of tests in 1982-83 to determine whether contracts with private firms could reduce state costs for highway maintenance, but when we studied the results in 1985, the state lacked a clear definition of maintenance and could not estimate its actual costs to maintain highways or the necessary amount of materials.<sup>3</sup> Although the Department of Transportation found that the overall quality of contractors' work was acceptable, we discovered during the course of this study that it has not studied the feasibility of maintenance contracts further since 1983 and still cannot clearly define maintenance work or identify its actual costs.

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**Agencies  
sometimes  
lacked cost  
data to  
compare state  
and nonstate  
services.**

<sup>2</sup> *Minn. Laws* (1988), Chapter 661, Section 3, Subd. 3(b).

<sup>3</sup> Office of the Legislative Auditor, *Highway Maintenance* (January 1985).

In other cases, while trying to identify comparable state and nonstate services, we found that some services might nominally be the same, but clients could be substantially different. For example, we did not compare the costs and benefits of state-operated community services for the mentally retarded or regional treatment center programs because residents may be more severely impaired than those who are served in nonstate facilities. There is no existing method to determine whether this is true but, in contrast, we could compare state and nonstate nursing home services since these residents' care needs are assessed through a standard system.<sup>4</sup>

Other times, nonstate workers have supplemented the work of state employees, but agencies have not adequately identified all costs. For example, Minnesota followed the lead of most other states in 1990 and implemented an Adopt-A-Highway program to reduce the need for state employees to pick up highway litter.<sup>5</sup> However, unlike some other states, the Department of Transportation did not charge application fees. When public response was much greater than expected, the department spent considerably more money than it originally budgeted.

Similarly, the 1969 Legislature authorized the Department of Transportation to contract with needy, elderly workers to maintain most highway rest stops and tourist information centers.<sup>6</sup> While the fiscal year 1991 contract covered salaries, mileage for some workers, training, uniform allowances, and administrative costs, the Department of Transportation paid directly for supplies and equipment. Also, it is hard to determine the true cost of maintenance by contract workers versus state employees because they work for different lengths of time. Although contract workers receive less than half the wages of state workers who would otherwise do maintenance, it generally takes contract workers longer to do the necessary work. On the other hand, contract workers may provide the additional benefit of discouraging vandalism by simply being on site longer.

## CASE COMPARISONS

To systematically compare the costs and benefits of state services, we focused on six areas where we could establish that the state is providing essentially the same services as the private sector or other units of government. All of these are or could be obtained by contracts: (1) motor vehicle registrations, (2) nursing home care, (3) fish rearing, (4) tree nurseries, (5) printing, and (6) routine computer programming and systems analysis. We addressed the following questions in each case:

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4 For a description of this method, see Office of the Legislative Auditor, *Nursing Homes: A Financial Review* (January 1990).

5 Last year, the Department of Transportation contracted with more than 4,000 community groups to pick up litter at least three times a year along small segments (usually two miles) of Minnesota's highways. Volunteers cleaned more than 8,000 of the state's 12,000 miles of trunk highways, thereby permitting state workers to concentrate on more urgent work.

6 *Minn. Laws* (1969), Chapter 157, Section 1.

- What is the price difference between the state and other service providers for essentially the same service?
- Why is the state more or less costly?
- What are the nonmonetary costs and benefits of the state providing the service?

Our systematic comparisons involved the Departments of Administration, Natural Resources, Human Services, and Public Safety. However, some of these departments negotiate contracts for services, such as printing and routine computer programming, which are provided to other departments.<sup>7</sup>

Because the objects of study varied so much, we used different techniques to make specific comparisons. However, in each case, we interviewed department staff and discussed their rationale at length. Also, we read relevant reports and documents. It is important to note that we did not study the entire operation of any one agency, but focused on those services which were also available elsewhere.

First, we compared the state's costs to provide services with prices on the open market. These comparisons were narrow and limited in scope because results otherwise could be difficult to interpret. We did not specifically examine whether the quality or speed of services was identical.

We recognize that it may be difficult for agencies to set prices to cover costs, even when required to do so. Unlike the private sector, state services are generally not operated for profit. While fluctuations in revenues and expenses affect private firms' profit margins, similar fluctuations for the state may determine whether agencies break even.

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**We identified costs and benefits of the state delivering six specific services.**

Second, we identified the overall costs and benefits of the state delivering specific services. Although we consulted agency staff to develop inventories of the nonmonetary advantages and disadvantages of state versus nonstate service delivery, we emphasize that our final analysis was subjective. In the following sections, we acknowledge that personal experience, policy preferences, and political perspectives may affect whether something is viewed as a benefit or a cost.

Further, we recognize that these are only some of the services that we could have studied. However, the Commission on Reform and Efficiency is identifying other opportunities for increased use of alternatives, and we restricted our studies to cases which clearly met our criteria, as previously discussed.<sup>8</sup>

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<sup>7</sup> By law, major printing contracts are governed by procedures for commodities contracts, not professional/technical services. See *Minn. Stat.* §16B.01, Subd. 5.

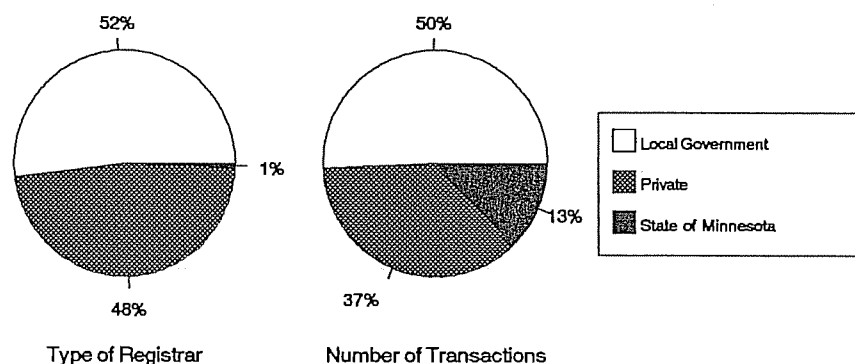
<sup>8</sup> Commission on Reform and Efficiency, "Carlson Outlines CORE, Minnesota Milestones," *News Release* (April 22, 1991).

## Motor Vehicle Registrations

The Department of Public Safety is the state's largest processor of motor vehicle registrations, but the law also permits corporations, private individuals, cities, and counties (all known as deputy registrars) to process registrations throughout the state.<sup>9</sup> This dual delivery system has operated for many years, mainly because it would be difficult to staff state offices at so many locations throughout Minnesota. Compared with most states' delivery systems, Minnesota's approach is considered innovative.<sup>10</sup>

In all, as we show in Figure 3.1, there are 166 deputy motor vehicle registrars and they are split almost evenly between the private sector and local units of government. Counties accounted for 33 percent of deputy registrars, and cities 19 percent. Private corporations represented 37 percent, and individuals 10 percent.<sup>11</sup>

Figure 3.1: Motor Vehicle Registrars and Transactions



Source: Department of Public Safety, FY 1990.

<sup>9</sup> *Minn. Stat.* §168.33. authorizes the Department of Public Safety to appoint others as deputy registrars, subject to department regulations regarding distance and workload. Counties that do not choose to become deputy registrars may also appoint deputy registrars in their place, subject to state regulations.

<sup>10</sup> Joan W. Allen et al., *The Private Sector in State Service Delivery* (Washington: Urban Institute Press, 1989).

<sup>11</sup> In practice, some corporations differ little from those owned by private individuals. The 1984 Legislature amended statutes to prohibit private individuals from selling or transferring their offices, but corporations are still free to do so.

The state and deputy registrars processed 4,804,606 motor vehicle registrations during fiscal year 1990. As is also shown in Figure 3.1:

- **The state and local units of government accounted for the majority of fiscal year 1990 motor vehicle transactions.**

The state and local governments processed nearly two-thirds of all motor vehicle registrations. The state's one office, located in the Transportation Building, processed about 13 percent of all registrations (about two-thirds through the mail and one-third at its public counter). Cities and counties accounted for fifty percent of the 4.8 million registrations during fiscal year 1990. In contrast, corporations accounted for about 30 percent of registrations, and private individuals 6 percent.

We looked at the Department of Public Safety's cost to process motor vehicle registrations at its public counter in the Transportation Building. About 16 state workers accept payment and enter motor vehicle registration data on-line.

In contrast, deputy registrars do not enter data directly on-line. Rather, they accept completed forms and fees and send them to the Department of Public Safety where state workers process the information.<sup>12</sup> Because deputy registrars do not have direct access to the state's data base, they call the department about 1,500 to 2,000 times per day to verify registration records.

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### **Motor vehicle registration is lucrative.**

Despite these differences in responsibilities, the state and deputy registrars collect the same fee for each motor vehicle registration. In recent years, we found that:

- **Motor vehicle registration fees have increased faster than the Minneapolis-St. Paul inflation rate.**

Since 1978, registration fees have increased 133 percent, from \$1.50 per transaction to \$3.50. In contrast, the Minneapolis-St. Paul Consumer Price Index increased 113 percent during the same period. The most recent increase occurred in 1989, when the Legislature increased fees by \$0.25.<sup>13</sup>

Consequently:

- **Motor vehicle registration fees have represented a substantial source of revenue for both the state and deputy registrars.**

As the data in Table 3.1 show, registrars collected nearly \$17 million dollars in fees during fiscal year 1990. The state collected about \$2.2 million in filing fees through its public counter and the mail, and the proceeds were divided between the state's general fund and the highway user tax distribution fund. Cities and counties earned nearly \$8.5 million, while corporations and private individuals grossed \$5.1 and \$1.1 million respectively. On average, cities and

<sup>12</sup> The state is working to automate procedures for some large public deputy registrars.

<sup>13</sup> *Minn. Laws* (1989), Chapter 269, Section 41.

**Table 3.1: Motor Vehicle Fees Collected by Type of Registrar**

<u>Type of Registrar</u>	<u>Total Fees</u>
Local Government	\$8,477,819
Corporations	5,057,451
Private Individuals	1,089,147
State Government	2,191,703
Public Counter	683,886
Mail-In	1,507,817
Total	\$16,816,120

Source: Department of Public Safety, fiscal year 1990.

counties earned about \$98,600 each, corporations \$81,600, and private individuals \$64,100.

However, revenues fluctuate somewhat with the total number of vehicles which must be registered each year. Some types of vehicles, such as utility trailers and tax-exempt vehicles, must be registered every two years. While about 40,000 tax-exempt vehicles were registered in 1991, over 500,000 utility trailers must be registered in 1992. Thus, we looked at the Department of Public Safety's expenses for two years (fiscal year 1991 and projections for 1992) to process motor vehicle registrations at its public counter. Results showed that:

- Motor vehicle registration fees are projected to more than cover the state's processing costs.

**Like deputy registrars, the state makes money by registering motor vehicles.**

The Department of Public Safety estimates that it will cost about \$1,062,000 to operate its public counter in fiscal years 1991 and 1992. Assuming it processes about the same number of motor vehicle registrations as in previous years (about 339,400), its processing cost will be about \$3.13 each. Since automobile owners pay \$3.50 per registration, the department should collect about \$1,187,900 in fees from its public counter, and the state should come out about 12 percent ahead per registration.

Figure 3.2 summarizes various costs and benefits of the state processing motor vehicle registrations for the public. As is indicated, we could find few important reasons why the state should operate its own public counter for motor vehicle registrations, except that it makes money overall. In fact, one of the state's largest deputy registrars is across the street from the Transportation Building and is open more hours daily and also on Saturdays.

In our opinion, the state could stop operating its public counter since alternatives are functional and regulated by the Department of Public Safety. Special cases such as reissuing previously revoked motor vehicle registrations, which

**Figure 3.2: Benefits and Costs of the State Selling Motor Vehicle Registrations**

	Individual	Department or Community	State or Public
<b>Benefits</b>	<ul style="list-style-type: none"> <li>• Faster processing time for some types of registrations</li> <li>• Employs state workers with full benefits</li> </ul>	<ul style="list-style-type: none"> <li>• May help offset cost of operating the public counter for other services</li> </ul>	<ul style="list-style-type: none"> <li>• Earns revenue for the general and highway user tax distribution funds</li> <li>• More current data base for law enforcement purposes</li> </ul>
<b>Costs</b>	<ul style="list-style-type: none"> <li>• Deprives private sector of opportunity to profit</li> <li>• Less convenient hours than alternatives</li> </ul>	<ul style="list-style-type: none"> <li>• Duplication of services</li> </ul>	<ul style="list-style-type: none"> <li>• Inflates the size of state government</li> </ul>

only the Department of Public Safety can do, could be handled on a case-by-case basis. However, our analysis suggests that the state can process registrations more quickly and efficiently than deputy registrars, and closing the public counter would shift some of the workload into other areas of the Department of Public Safety. Therefore, we conclude that:

- **Because the state's costs are covered overall, there is little compelling reason why the department should stop processing motor vehicle registrations at its public counter.**

On the other hand, we think that the state should more carefully examine the connection between processing costs and fees. Currently, the state has no objective means to determine how fees are set or adjusted. Although automobile owners, not the state directly, pay for registration services, we believe that the state is responsible for setting fees which are a fair and a reasonable reflection of costs.

## Nursing Home Care

The State of Minnesota entered into the business of nursing home care in the early 1960s. Presently, the Department of Human Services operates three facilities: Ah-Gwah-Ching Nursing Home near Walker with 343 licensed beds, Woodhaven Senior Community at the Brainerd Regional Treatment Center with 28 licensed beds, and Faribault Regional Center with 35 licensed beds. A fourth facility, Oak Terrace Nursing Home in Minnetonka, had 322 licensed beds but ceased operating on June 30, 1991.<sup>14</sup> During fiscal year 1990, Minne-

<sup>14</sup> The Department of Human Services leases the Oak Terrace Nursing Home from Hennepin County for \$40,000 per month. Although the department closed the facility in June 1991, by November it still had not terminated its lease with the county. See Office of the Legislative Auditor, *Department of Human Services Oak Terrace Nursing Home Financial Audit, July 1989 to November 1991* (January 1992).



sota spent approximately \$26 million to serve 528 residents at these facilities--an average cost of about \$49,000 per person.<sup>15</sup>

We studied the cost of nursing home care in state facilities and compared it with the Medicaid reimbursement rate which the Department of Human Services pays to nonstate-operated nursing homes.<sup>16</sup> For the most part, we concentrated on costs for Ah-Gwah-Ching and Oak Terrace Nursing Homes, which each employed about 300 staff. We did not examine costs for Woodhaven Senior Community because it only opened in August 1989, and we excluded Fari-bault Regional Center because it is restricted to developmentally disabled residents who need highly specialized care.

We examined costs in three ways in our study. First, we compared total expenditures for state-operated nursing homes with the federal government's reimbursement rates, nationally known as "routine service limits." Second, we compared state nursing home costs with the average rates paid to nonstate-operated homes during 1989. Third, using a special report prepared by the Department of Human Services, we calculated costs for various levels of care at Ah-Gwah-Ching Nursing Home and compared these costs with the average rates paid to nonstate-operated homes for similar services. In addition, we estimated the cost of state nursing homes compared with the alternative of non-state facilities.

The data in Table 3.2 show total daily costs per state nursing home resident for fiscal years 1989 and 1990. As indicated, it cost an average of \$120.31 daily per resident to provide services at Ah-Gwah-Ching Nursing Home in 1989 and \$124.63 in 1990. Almost all of these costs were eligible for reimbursement under federal routine services limits.

However, actual federal reimbursement for nursing home services was considerably less than eligible costs. As with most health care reimbursement systems, the federal government does not reimburse states beyond certain spending limits which are fixed for each state. Table 3.2 also shows that:

- In fiscal years 1989 and 1990, federal reimbursement was about 39 percent less than what the state actually spent for eligible services.

In effect, Minnesota spent from \$39 to \$53 more per resident day than was eligible for reimbursement in fiscal year 1989, and about \$52 more in 1990. While the state pays about 47 percent of the routine service limit and the federal government 53 percent, the state must pay all eligible expenses above the limit.

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<sup>15</sup> Because the Department of Human Services was phasing out Oak Terrace Nursing Home during 1990, overall costs per resident may be somewhat inflated.

<sup>16</sup> We compared the Medicaid reimbursement rates with state costs because they represent what it would actually cost the state or consumers to buy services from other nursing homes. For a detailed analysis of nonstate-operated nursing home rates, see Office of the Legislative Auditor, *Nursing Homes* (1990).

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**Since the federal government won't pay all of the state nursing home residents' expenses, Minnesota picks up the difference.**

**Table 3.2: Daily Cost Per State Nursing Home Resident, FY 1989-90**

	<u>1989</u>	<u>1990</u>
<b>Total Cost<sup>a</sup></b>		
Ah-Gwah-Ching Nursing Home	\$120.31	\$124.63
Oak Terrace Nursing Home	126.51	156.82
<b>Costs Eligible for Reimbursement<sup>b</sup></b>		
Ah-Gwah-Ching Nursing Home	\$117.00	\$121.46
Oak Terrace Nursing Home	119.74	147.89
<b>Routine Service Limit</b>		
Ah-Gwah-Ching Nursing Home	\$63.53	\$69.87
Oak Terrace Nursing Home	80.38	95.87

Source: Department of Human Services.

<sup>a</sup>Total cost refers to what it costs government per resident to operate state nursing homes, including normal nursing care, medications, doctors' visits, therapy, capital, and Department of Human Services' overhead and administrative costs.

<sup>b</sup>Costs eligible for reimbursement under routine service limits exclude some expenses which are disallowed by the federal government.

We looked at the average reimbursement rates for nonstate-operated nursing homes and compared them to expenses for similar services in state-operated nursing homes. To the extent possible, we excluded from state nursing homes' costs those expenses which nonstate nursing homes bill separately, such as doctors' visits, medications, and therapy. This comparison revealed that:

- Overall, nonstate nursing homes charged about 40 percent less to provide similar nursing home services than what it cost in state nursing homes during the same time period.

During 1989, nonstate-operated nursing homes charged an average daily rate of \$68.41, although rates ranged from \$35.72 to \$134.06. In comparison, average daily costs for similar services were \$114.69 at Ah-Gwah-Ching Nursing Home and \$119.59 at Oak Terrace Nursing Home for 1989.

**Nonstate nursing home rates were considerably lower than state nursing home costs, even for similar types of care.**

Using a special report done by the Department of Human Services, we also compared daily costs for residents requiring different levels of care in Ah-Gwah-Ching Nursing Home with the rates charged to like residents in nonstate-operated nursing homes. In the following two comparisons, however, we were unable to exclude state nursing home costs for some services which nonstate nursing homes bill separately. For Ah-Gwah-Ching Nursing Home, this amounted to at least \$509,000, or about \$6 per resident daily, in 1989.

As shown in Table 3.3, we learned that:

**Table 3.3: Daily Costs for Ah-Gwah-Ching Nursing Home Residents Compared with Nonstate Nursing Homes' Average Daily Rates**

Case-Mix Level <sup>a</sup>	Group 1 Deep-Rural Homes	Group 2 Semi-Metro Homes	Group 3 Metro Homes	Ah-Gwah-Ching Nursing Home Costs <sup>b</sup>
A	\$38.01	\$40.86	\$49.13	\$85.76
B	40.94	44.04	53.12	93.86
C	44.26	47.65	57.63	-- <sup>c</sup>
D	47.28	50.95	61.73	111.42
E	50.40	54.34	65.96	120.06
F	50.60	54.55	66.22	-- <sup>c</sup>
G	53.23	57.42	69.79	127.90
H	58.21	62.83	76.53	141.67
I	59.96	64.74	78.90	146.53
J	62.70	67.71	82.60	154.10
K	68.45	73.96	90.40	-- <sup>c</sup>

Source: Department of Human Services, fiscal year 1989.

Note: Rates for nonstate operated nursing homes are determined partially by their geographic location. Ah-Gwah-Ching Nursing Home would be classified as a Group 1, deep-rural facility. These homes can be reimbursed at their own rates or the rate of Group 2 homes, whichever is greater. The Department of Human Services has used Group 2 rates for Group 1 homes since 1987.

<sup>a</sup>Case-mix level refers to the amount of care each resident requires, with "A" being the least and "K" the most.

<sup>b</sup>Costs include expenses which nonstate nursing homes generally bill separately, which amount to at least \$6 per resident day.

<sup>c</sup>Ah-Gwah-Ching Nursing Home did not have residents at case-mix levels "C," "F," or "K."

- Nonstate-operated nursing homes in the metropolitan area charged an average of about 45 percent less than what it cost in Ah-Gwah-Ching Nursing Home, and rates in semi-metropolitan or deep rural areas were about 55 percent less.

Because Ah-Gwah-Ching Nursing Home became federally certified as an Institution of Mental Disease (IMD) in 1987, we further compared its costs with the rates of nonstate nursing homes which also have this designation.<sup>17</sup> We found that nonstate-operated nursing homes which were certified as Institutions of Mental Disease charged about 45 percent less than it cost at Ah-Gwah-Ching Nursing Home. Nonstate nursing homes which had both this designation and which served a similar array of residents at each case-mix level charged about 39 percent less than state costs.

We examined various reasons for state nursing homes' higher costs. As we explained above, state costs might include spending for some services, such as medications, therapy, and doctors' visits, which most nonstate nursing homes bill separately. To the extent that this is occurring, we estimate that state costs

<sup>17</sup> Facilities certified as Institutions of Mental Disease provide medical attention, nursing care, and related services to elderly persons with mental diseases.

in some cases could be inflated by at least \$6 per resident per day. (See Table 3.3.) In our opinion, however, the following three reasons are more important. These include: (1) staffing, (2) resident characteristics, and (3) physical plant.

As we show in Table 3.4, salaries in general are much higher in the state's major nursing home. Specifically, we found that:

- Median salaries at nonstate-operated nursing homes were 20 to 40 percent lower than in Ah-Gwah-Ching Nursing Home, and salaries in community hospitals were 8 to 32 percent lower during 1989.

Furthermore, we learned that:

- Nonstate-operated nursing homes were staffed approximately seven percent lower than Ah-Gwah-Ching Nursing Home.

**Table 3.4: Median Hourly Wage for Nursing Home and Hospital Staff**

Job Class	Ah-Gwah-Ching Nursing Home	Nonstate Nursing Homes	Community Hospitals	Percent Difference: State-Nonstate Nursing Homes	Percent Difference: State Nursing Home- Community Hospitals
Administrator	\$26.73	\$18.25	<sup>a</sup>	32%	--
Clerk Accounting/Insurance	10.36	7.85	<sup>a</sup>	24	--
Clerk Typist	9.68	7.00	7.44	28	23%
Cook	10.36	6.50	7.08	37	32
Dietary Supervisor or Chief Cook	11.49	8.70	9.40	24	18
Dietitian, Registered	17.76	12.56	14.19	29	20
Engineer, Maintenance	14.03	9.25	<sup>a</sup>	34	--
Executive Housekeeper	12.73	8.25	9.47	35	26
Janitor	9.48	6.70	8.27	29	13
Kitchen Helper	9.11	5.57	6.69	39	27
Laundry Worker	9.58	5.85	<sup>a</sup>	40	--
Manager, Laundry	11.53	7.53	<sup>a</sup>	35	--
Nurse, Assistant	9.82	6.04	7.17	39	27
Nurse, Director	19.87	14.10	17.88	29	10
Nurse, Licensed Practical	11.22	8.70	9.30	22	17
Nurse Staff (RN)	16.17	11.87	13.74	27	15
Physical Therapist	21.65	16.00	14.68	26	32
Physical Therapy Technician	10.63	6.41	8.56	40	19
Receptionist/Switchboard Operator	9.82	5.93	6.75	40	31
Social Worker	11.91	9.50	10.99	20	8
Supervisor, Office	12.27	9.30	<sup>a</sup>	24	--

Sources: Minnesota Department of Jobs and Training, 1989, and Department of Human Services, 1989.

<sup>a</sup>No comparable job title.

The Department of Health's regulations require at least two nursing hours per resident day. We learned that nonstate homes provided 2.64 nursing hours per resident day in 1989 while Ah-Gwah-Ching Nursing Home provided 2.85 nursing hours per resident day. Even when we controlled for residents' care needs, Ah-Gwah-Ching Nursing Home was staffed higher.

Table 3.5 shows the percentage of residents who needed increasing levels of care and were served at state and nonstate-operated homes. As is shown, state nursing homes had higher concentrations of residents with behavior problems than nonstate operated homes. Also, higher percentages of Ah-Gwah-Ching Nursing Home's population were admitted from regional treatment centers and were younger men.

**Table 3.5: Percent of Residents at Case-Mix Levels**

<u>Case-Mix Level<sup>a</sup></u>	<u>Nonstate Nursing Homes</u>	<u>Ah-Gwah-Ching Nursing Home</u>	<u>Oak Terrace Nursing Home</u>
A Low ADL	24%	6%	3%
B Low ADL and behavior problems	8	38	33
C Low ADL and special nursing needs	0	0	0
D Medium ADL	10	1	2
E Medium ADL and behavior problems	7	30	26
F Medium ADL and special nursing needs	0	0	0
G High ADL	16	2	2
H High ADL and behavior problems	9	10	8
I Very high ADL (eating 3-4)	6	1	2
J High ADL, severe neurological impairment, behavior problems	17	13	23
K High ADL and special nursing needs	4	0	1

Note: Percents may not total 100 due to rounding.

Source: Department of Human Services, 1989.

<sup>a</sup>Residents' care needs are determined by their ability to perform eight key activities of daily living (ADLs): dressing, grooming, bathing, eating, bed mobility, transferring, walking, and toileting. The need for clinical monitoring and behavioral intervention is considered also. Each category carries with it an estimate of the number of staff hours needed for individual residents. In general, residents classified at the "A" level require considerably less nursing care than residents at the "K" level.

We recognize that residents in state-operated nursing homes may have special needs, but our study showed that nonstate homes served a wide variety of residents. As we show in Table 3.5, in either case, about one-third of the residents were in the lowest two categories of need ("A" and "B"). Neither state nor nonstate homes had many residents who required special nursing care, although the majority of residents in state homes had behavior problems which are covered in the case-mix classification system.

Finally, the state's major nursing home is large and old (built around the turn of the century). Ah-Gwah-Ching Nursing Home covers a 219-acre campus, and Oak Terrace Nursing Home had 76 acres. Facility staff do all maintenance and, due to the age and number of buildings, repairs are a constant and costly problem.

Based on our cost comparisons, we calculated the state's possible savings if it should decide to reduce its nursing home services. Our results showed that:

- The state could have spent about \$300,000 less at Ah-Gwah-Ching Nursing Home if residents without behavior problems instead were served by nonstate-operated homes in 1989.
- The state could have spent approximately \$4 million less during 1989 if Ah-Gwah-Ching Nursing Home residents instead were served by nonstate-operated homes.

Essentially, the latter type of transfer has already been made for Oak Terrace Nursing Home residents. As it closed between July 1989 and June 1991, we learned that 85 percent of its residents went to nonstate-operated nursing homes, 11 percent to other state facilities, and 7 percent elsewhere (hospitals, veterans facilities, or home). Thus, most of Ah-Gwah-Ching Nursing Home's residents could be placed elsewhere because data show that they tend to have fewer care needs than the Oak Terrace residents.

Figure 3.3 summarizes our analysis of the major costs and benefits of maintaining a state-operated system of nursing homes. If the state stopped operating its largest nursing home, the biggest costs probably would involve employee layoffs and damage to one community's economic base. However, we think that mass unemployment is unlikely in light of the general shortage of health care workers and the abundance of nonstate nursing homes. From

**Figure 3.3: Benefits and Costs of State-Operated Nursing Homes**

	Individual	Department or Community	State or Public
<b>Benefits</b>	<ul style="list-style-type: none"> <li>• Stable environment for residents</li> <li>• Employs state workers with full benefits</li> <li>• Higher level of staffing</li> </ul>	<ul style="list-style-type: none"> <li>• Good for local economy</li> <li>• Act as incentive to raise salaries and working conditions in area health facilities</li> <li>• Can be used to test new department programs</li> <li>• Lowers overall costs of regional treatment centers, if co-located</li> </ul>	<ul style="list-style-type: none"> <li>• Promote state policies such as comparable worth</li> </ul>
<b>Costs</b>	<ul style="list-style-type: none"> <li>• Residents may be stigmatized by institutionalization in state facilities</li> <li>• Few service sites, with none in the Twin Cities area</li> <li>• Deprives private sector of opportunity to profit</li> </ul>	<ul style="list-style-type: none"> <li>• Unfair competition to non-state nursing homes</li> <li>• Old buildings require capital investment</li> <li>• More costly to operate than nonstate homes</li> <li>• Limited cost-containment incentives</li> <li>• Similar services available elsewhere</li> </ul>	<ul style="list-style-type: none"> <li>• Inconsistent with deinstitutionalization policy</li> <li>• Inflates the size of state government</li> <li>• Places costly burden on state government</li> </ul>

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**Minnesota has a large, well-regulated, and professional nursing home industry.**

September 1989 through May 1991, 99 staff at Oak Terrace Nursing Home took other state or public jobs, 15 resigned or retired, 31 were on temporary, emergency, or student appointments which ended, and 93 workers were separated with enhanced benefits.<sup>18</sup>

Extra costs could be inevitable if state nursing homes were a last resort for persons the private sector was neglecting. However, as we showed, the overall care needs of residents at Ah-Gwah-Ching Nursing Home were lower than residents of nonstate homes, although they had more behavior problems. However, our 1990 study of nursing homes showed that private sector homes are increasingly specialized and professional.<sup>19</sup> For example, nursing homes have developed units for Alzheimer patients and young adults. Also, like Ah-Gwah-Ching Nursing Home, a number of nonstate nursing homes have become certified as Institutions for Mental Disease. As an incentive to encourage more nonstate-operated nursing homes to specialize in serving more difficult residents, the Department of Human Services could establish special reimbursement rates for them, as it has for other nursing home populations.

In conclusion:

- We could not find any compelling reason for the state to continue to operate its own large nursing home.

In light of the state's uncertain financial situation, it may be prudent for the state to examine its commitment to nursing homes in general. We understand that, in light of the state's general financial condition, the Department of Human Services is looking at such issues. Nursing homes' quality of care and sense of accountability are strong throughout Minnesota, and both public and private facilities alike are inspected routinely by as many as 13 different agencies.<sup>20</sup>

## **Fish Rearing**

The state has been raising and stocking fish since 1873, when the first Fish Commission was established. The state's early efforts focused on fish as potential food sources, particularly whitefish, carp, salmon, and trout. By the early 1900s, however, the state stopped stocking carp and began to concentrate on trout, walleye, bass, and other native fish. By the 1920s, the state operated six hatcheries.

Since that time, the Department of Natural Resources has vastly expanded its capacity to raise fish. In 1990, the department operated 20 hatcheries, produced over 291 million fish, and stocked about 232 million of them in Minnesota's lakes, rivers, and streams.

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<sup>18</sup> Department of Human Services, *Oak Terrace Nursing Home Annual Report FY 91* (June 1991).

<sup>19</sup> Office of the Legislative Auditor, *Nursing Homes* (1990).

<sup>20</sup> Department of Health, *A Review of the Inspection Activity in Hospitals and Nursing Homes: Recommendations for the Coordination of Inspections in Hospitals and Nursing Homes* (March 1990).

For many years, private fish growers have pressured the Department of Natural Resources and state legislators to further increase stocking efforts. The private fish growers have suggested that they could raise the extra fish more cheaply than the state. In response, the 1989 Legislature required the Department of Natural Resources to contract with an independent consultant to objectively study costs.<sup>21</sup> In consultation with the Legislative Commission on Minnesota's Resources, the department selected KPMG Peat Marwick to do the study which was finished in October 1990.<sup>22</sup>

Although others have argued about certain methodological aspects of the study, in our opinion, the Peat Marwick report provides the necessary information for comparing the costs to raise fish at state and private facilities. However, we supplemented the cost data with our own analysis of nonmonetary costs and benefits.

The data in Table 3.6 summarize the number and type of fish stocked by the Department of Natural Resources in 1989. As indicated, the Peat Marwick report determined the cost to raise 84 percent of the species stocked by the department by weight. Peat Marwick based its determination of the state's costs largely on fiscal year 1989 state accounting data. It updated the figures for inflation and added capital costs according to a standard method. To obtain private prices, the consultant asked 25 private fish growers to indicate the prices that they would charge the state for fish in 1991 or 1992. Thirteen private fish growers responded.

**Table 3.6: Department of Natural Resources' Fish Stocking**

<u>Species</u>	<u>Pounds</u>	<u>Number</u>	<u>Species</u>	<u>Pounds</u>	<u>Number</u>
Brook Trout <sup>a</sup>	10,493	279,613	Channel Catfish	4,041	69,788
Brown Trout <sup>a</sup>	31,709	620,150	Crappie	1,376	2,066
Chinook Salmon <sup>a</sup>	5,643	518,319	Flathead Catfish	1,122	736
Lake Trout <sup>a</sup>	29,622	579,048	Hybrid Sunfish	21	50
Rainbow Trout <sup>a</sup>	160,383	2,628,492	Lake Sturgeon	298	7,150
Muskellunge <sup>a</sup>	6,487	30,585	Largemouth Bass	906	88,232
Tiger Muskellunge <sup>a</sup>	563	1,767	Northern Pike	31,739	1,030,223
Walleye <sup>a</sup>	152,074	347,598,896	Pumpkinseed Sunfish	428	945
Atlantic Salmon	5,937	144,343	Smallmouth Bass	1,094	83,042
Splake	4,990	122,874	Sunfish	29	125
Black Bullhead	843	1,808	Yellow Perch	2,522	48,775
Black Crappie	7,390	79,772			
Bluegill	13,522	183,382	Total	473,232	354,120,181

Source: Department of Natural Resources, 1989.

<sup>a</sup>Species included in KPMG Peat Marwick cost comparison study.

<sup>21</sup> *Minn.Laws* (1989), Chapter 335, Article 1, Subd. 7.

<sup>22</sup> KPMG Peat Marwick, *Fish Hatchery Cost Comparison Study* (Minneapolis, October 1990).



The results in Table 3.7 compare state costs to raise various fish with private prices. As shown:

- It cost less for the Department of Natural Resources to raise most types of fish itself rather than purchase them from private growers.

**Table 3.7: Department of Natural Resources' Costs Compared with Private Prices**

	State Cost Per Fish <sup>a</sup>	Range of Private Prices	Average Private Price Per Fish <sup>b</sup>
<b>State Costs are Less Expensive</b>			
Walleye Fingerlings	\$0.20 - 0.24	\$0.26 - 0.90	\$0.55
Brook Trout Fingerlings	0.13 - 0.15	0.23 - 0.64	0.43
Lake Trout Fingerlings	0.18 - 0.21	-- <sup>c</sup>	0.79
Lake Trout Yearlings	0.55 - 0.65	-- <sup>c</sup>	1.06
Kamloop Rainbow Trout Fingerlings	0.08 - 0.10	0.23 - 0.74	0.49
Kamloop Rainbow Trout Yearlings	0.51 - 0.61	0.69 - 1.06	0.87
Chinook Salmon Smolt	0.04 - 0.05	-- <sup>c</sup>	0.48
<b>State Costs are More Expensive</b>			
Muskellunge Fingerlings	9.20 - 10.95	2.12 - 5.72	4.15
Tiger Muskellunge Fingerlings	9.20 - 10.95	2.12 - 9.54	5.13
Brook Trout Yearlings	1.06 - 1.27	0.84 - 1.06	0.95
Brown Trout Fingerlings	0.28 - 0.34	0.04 - 0.32	0.18
Rainbow Trout Yearlings	1.19 - 1.42	0.42 - 1.06	0.74
<b>State Costs are About the Same</b>			
Brown Trout Yearlings	0.82 - 0.98	0.84 - 0.85	0.84
Rainbow Trout Fingerlings	0.16 - 0.19	0.12 - 0.64	0.38

Source: KPMG Peat Marwick, 1990.

Note: Fingerlings are small, young fish about the length of a finger. Once they reach a year old, they become yearlings.

<sup>a</sup>This range represents a point estimate, derived from an analysis of Department of Natural Resources' data, plus a margin to allow for facilities contribution, allocation variance, and inflation.

<sup>b</sup>Private prices include state sales tax.

<sup>c</sup>Only one private firm submitted a price for this fish.

The Department of Natural Resources' costs were lower than private sector prices in seven cases, higher in five, and about equal in two. The fish where state costs were less expensive represented about 40 percent of the state's total stocking effort by weight in 1988, 53 percent in 1989, and 34 percent in 1990, while the fish where state costs were more expensive represented about 25, 20, and 16 percent respectively.

In addition, the study found that state and private growers used similar methods to raise fish, and both hired staff with appropriate training and skills. How-

ever, as noted earlier, state employees probably were paid more than their private sector counterparts.

The major reason for cost differences turned out to be volume; that is, the more fish produced, the lower cost per fish. Certain state costs such as administrative salaries were fixed, but since state hatcheries raised millions of fish, state costs per fish tended to be low.

Based on costs, the Peat Marwick study made two major recommendations:

1. The state should consider contracts to purchase fish which the private sector can supply more cheaply.
2. The department should analyze the costs and benefits of contracting for those species where state and private costs are about the same.

We generally agree with these recommendations, some of which the Department of Natural Resources has already implemented. We spoke with the department and learned that it purchased an entire species of fish (tiger muskellunge) which it raised previously from a private grower and is contracting with another for all lake sturgeon production. However, the data suggest that savings, if any, will be minor. One reason is that the department moved some fish of another species into the space previously used to rear tiger muskellunge. Another reason is that the state stocks few of the fish which cost less for the private sector to produce.

State costs for walleye, the most heavily stocked species, are lower than private sector prices. Thus, the state has little reason to contract for supplemental walleye. Furthermore, state walleye hatcheries currently operate at less than full capacity.

Figure 3.4 summarizes the costs and benefits which we identified for the Department of Natural Resources' fish rearing program. On the positive side, this activity is a small part of the state's entire fish management program which aims to conserve and enhance the fish population through planned, scientific management, protection, and utilization. Because the department raises fish at many sites throughout the state, subsequent transportation costs for stocking may be kept low. Furthermore, the department is responsible ultimately for egg-taking, stocking, and the overall purity of the state's fish. The department generally does not permit private parties to raise and stock fish in public waters.<sup>23</sup>

Although state activities may impede the development of the private sector, we concluded that:

- **The benefits derived from having the state rear fish itself generally outweigh the disadvantages.**

<sup>23</sup> In some instances, the Department of Natural Resources has permitted groups and organizations to stock lakes and streams.

**Fish rearing fits into the state's larger fish management program and is economical for several species.**

**Figure 3.4: Benefits and Costs of State Fish Rearing**

	Individual	Department or Community	State or Public
<b>Benefits</b>	<ul style="list-style-type: none"> <li>• Stable fishing opportunities</li> </ul>	<ul style="list-style-type: none"> <li>• Activity is small part of overall fish management activities</li> <li>• Activity used to help educate the public</li> <li>• Generally less expensive for the state to raise fish</li> <li>• Many rearing sites which may lower transportation costs to stocking sites</li> </ul>	<ul style="list-style-type: none"> <li>• Helps ensure genetic purity of fish</li> <li>• Meets legislative goals to protect and enhance water and fish</li> </ul>
<b>Costs</b>	<ul style="list-style-type: none"> <li>• Deprives private sector of opportunity to profit</li> </ul>	<ul style="list-style-type: none"> <li>• May lead to overproduction and unnecessary stocking</li> </ul>	

However, as a rule, we think that the Department of Natural Resources should operate its hatcheries so that costs are fully covered and known. For example, it should routinely calculate fish production costs by size and species and keep abreast of private prices. These comparisons could also be used to help it monitor the efficiency of its activities and change accordingly.

## Tree Nurseries

Much of Minnesota's economy is based on a healthy timber industry. Forests cover nearly 17 million acres of land, or about one-third of the state's 50 million acres. Over 1,750 businesses manufacture wood-related products, making forest products the state's second largest manufacturing industry. Yet private industry owns only five percent of the state's 13.7 million acres of commercial forest land. Federal, state, and local government own 53 percent, while private individuals account for 42 percent. Thus, it is in the state's interest to encourage non-industrial owners to manage their forests wisely.

Part of the state's overall forest management strategy is to raise and sell low-cost seedlings to establish new forests and replant old ones. Minnesota state government thus has been in the tree nursery business since the early 20th century. Today, the state's two nurseries near Willow River and Akeley cover about 500 acres and, with about 50 staff and 300 seasonal workers, they distribute about 20 million seedlings annually. They sell about 60 percent of their stock to private individuals or industries, 20 percent to local units of government, and 20 percent to the state forestry division for use on state-owned land.

We concentrated on the Department of Natural Resources' prices for bareroot seedlings and compared its prices with those for similar products in the private sector. As shown in Table 3.8, the state sold 11 species of both conifer (ever-

**The DNR is one of the largest producers of forest tree and shrub seedlings.**

**Table 3.8: Department of Natural Resources' Nursery Prices**

	Per 1,000	Per 500	Per 100
Coniferous Seedlings <sup>a</sup>	\$85	\$45	\$12
Deciduous Seedlings <sup>b</sup>	150	78	20
Coniferous Transplants <sup>c</sup>	200	105	26

Source: Department of Natural Resources, 1991.

<sup>a</sup>Includes white pine, Norway pine, jack pine, Scotch pine, white spruce, Colorado spruce, white cedar, black spruce, Norway spruce, red cedar, and balsam fir.

<sup>b</sup>Includes green ash, white ash, silver maple, black walnut, Siouxi poplar, red oak, white oak, asorted oak, wild plum, caragana, and ginnala maple.

<sup>c</sup>Includes Norway pine, Colorado spruce, and white spruce.

green) and deciduous (hardwood) seedlings during 1991, and three species of conifer transplants.<sup>24</sup>

We made two cost comparisons. First, we compared what it would cost the public to buy nursery products from the state and five privately owned nurseries, controlling for species, age, and size.<sup>25</sup> We asked private nurseries whether they sold bareroot seedlings and, if they did, obtained their 1991 price list. We looked for prices for conifer seedlings which were generally three years old and at least six inches long, and deciduous seedlings which were usually two years old and at least eight inches long. According to the Department of Natural Resources, these were the sizes and ages of its seedlings. When possible, we also compared state nursery transplant prices with private prices for similar products.

Second, we examined whether revenue from the sale of nursery products covered expenses. Since 1982, the Legislature has required the Commissioner of Natural Resources to set seedling prices which cover the cost of stock and distribution.<sup>26</sup> In addition, the 1982 Legislature directed the department to develop a plan on the costs and benefits of making its nursery and tree

<sup>24</sup> Bareroot seedlings are usually planted outdoors in the fall in seedbeds and lifted for planting about two to three years later in the spring. Because their roots are not surrounded by soil which can provide nutrients, the seedlings must be planted soon after they are taken from the ground. Transplants are four year-old seedlings which have been grown for two years in one bed and then moved to another for two more years.

<sup>25</sup> It should be noted that most nurseries do not sell bareroot seedlings, especially for reforestation. Although there are hundreds of nurseries in Minnesota, the Department of Natural Resources estimates that about 10 to 20 actually sell bareroot seedlings in large quantities. Most private nurseries sell containerized seedlings which the Department of Natural Resources contracts for, when needed. Containerized seedlings are grown in a greenhouse for six to nine months in small containers ready for planting, have a longer shelf life than bareroot seedlings, and can be planted through the fall.

<sup>26</sup> *Minn. Laws* (1982), Chapter 511, Sections 14 through 17. Previously, prices simply had to be "fair and reasonable."

improvement program self-supporting.<sup>27</sup> The plan was completed and the overall conclusion was that it would be possible for the nursery program to be self-supporting. Although the plan was never formally adopted by the Legislature, the department has been trying to operate its nursery and tree improvement program on a self-sufficient basis. Thus, in setting prices for its stock, the Department of Natural Resources includes expenses for related tree improvement programs operated from the nurseries such as genetic experimentation and seed sales.

In general, it was very difficult for us to compare prices across nurseries. First, very few private nurseries sold exactly the same products as the state. For example, none of the private nurseries which we contacted sold deciduous seedlings which were the same age and size of the state's; their deciduous seedlings were usually younger or larger. Second, in some instances, minimum orders may be required. Third, unlike the state, private nurseries were more likely to grade and price their products by age and root length, with shorter, younger seedlings priced lower. This may have affected our price comparisons, causing private prices to be slightly inflated.

The data in Table 3.9 show 1991 prices for those species that we found were available from the state and private growers. As shown:

- State prices were significantly lower than those of private nurseries, regardless of the quantity or species purchased.

**Table 3.9: State and Private Nursery Prices**

Species	State		Private	
	Per 1,000	Per 100	Per 1,000	Per 100
Conifer Seedlings <sup>a</sup>	\$85	\$12	\$120-200	\$40-70
Transplanted Conifers <sup>b</sup>	200	26	325-500	50

Source: Office of the Legislative Auditor, 1991. Prices for each product came from at least three private nurseries.

<sup>a</sup>Includes white pine, white cedar, black spruce, balsam fir, Colorado spruce, and Norway spruce.

<sup>b</sup>Includes Norway pine, Colorado spruce, and white spruce.

**Privately produced seedlings were more expensive than state seedlings.**

On the average, private prices for 1,000 conifer seedlings ranged from \$120 to \$200, and prices for 100 conifer seedlings were from \$40 to \$70. The state's prices were \$85 and \$12 respectively. Private prices for 1,000 conifer transplants ranged from \$325 to \$500 and the price for 100 was \$50. The state's respective prices were \$200 and \$26.

Since the State of Minnesota is one of the largest producers of forest tree and shrub seedlings in the northeastern United States, volume again helps to explain why we found that state prices were lower than private firms. Also, state

<sup>27</sup> *Minn. Laws* (1982), Chapter 511, Section 13.

prices do not include profit. However, we discovered that state prices also were low because they failed to include all relevant expenses. In fact, we found that:

- **During fiscal year 1991, state nursery expenditures exceeded revenue by 16 percent.**

The Department of Natural Resources acknowledged to us that nursery operations have not been self-sufficient for many years. In fact:

- **Costs have exceeded revenue each year since 1985.**

The Legislature appropriated funds to the nursery account during fiscal year 1984 to help establish a working capital base. Since then, cash reserves have steadily declined. Since fiscal year 1985, the fund's operating cash balance has dropped by \$673,596, going from \$729,873 to \$56,279 in just six years.

We also learned that the Department of Natural Resources has become aware of its cash flow problem and has been trying slowly to correct the problem. In a 1989 financial audit, our office recommended that the department change its pricing structure to: (1) incorporate various depreciation factors, (2) use fiscal rather than calendar year costs to ensure the most current cost data, and (3) build in anticipated wage increases.<sup>28</sup>

The department has been changing its pricing structure, and officials told us that they hope to fully cover depreciation during 1992 and break even. The department raised 1992 prices by 12 to 67 percent, depending on the species and volume purchased, and it expects to ship nearly 7 percent more seedlings over the previous year.<sup>29</sup>

These price increases are not enough to rebuild an adequate cash reserve, but rather than increasing prices further, the department told us that it is trying to reduce operating costs. First, it is considering hiring contract workers rather than seasonal state employees. The seasonal workers' wages have averaged \$9.40 per hour, and the department has paid insurance and worker's compensation costs. Second, the department may create a new job classification for seasonal nursery workers which would have a lower pay range than the current Laborer I classification.

Figure 3.5 summarizes our analysis of the major costs and benefits of having the state operate its own tree nurseries. On the positive side, low-cost seedlings may further encourage reforestation, which is ultimately good for the state's economy. At the same time, the state by its actions has made it difficult

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<sup>28</sup> Office of the Legislative Auditor, *Department of Natural Resources Brainerd Region Financial and Compliance Audit for the Year Ended June 30, 1988* (November 1989).

<sup>29</sup> We subsequently contacted the State of Wisconsin and compared its 1991 prices because, as in Minnesota, its nursery operations also are expected to break even. The results showed that Wisconsin's prices for similar seedlings were also higher than Minnesota's. Its prices for 1,000 conifer and 1,000 deciduous seedlings were \$156 and \$214 respectively, compared with \$85 and \$150 in Minnesota.

**Figure 3.5: Benefits and Costs of State Tree Nurseries**

	Individual	Department or Community	State or Public
<b>Benefits</b>	<ul style="list-style-type: none"> <li>• Provides low cost seedlings</li> <li>• Long-term investment for each buyer</li> <li>• Provides seasonal jobs in two areas of the state</li> </ul>	<ul style="list-style-type: none"> <li>• Reduces the cost for seedlings needed by the department</li> <li>• Provides low cost seedlings to other units of government</li> <li>• Supports the tree improvement program</li> </ul>	<ul style="list-style-type: none"> <li>• Promotes reforestation</li> <li>• Supports the lumber industry</li> </ul>
<b>Costs</b>	<ul style="list-style-type: none"> <li>• Deprives private sector of opportunity to profit</li> <li>• Limited service sites</li> </ul>	<ul style="list-style-type: none"> <li>• Unfair competition with private nurseries</li> <li>• Overall, expenses exceed revenue</li> </ul>	<ul style="list-style-type: none"> <li>• May unnecessarily subsidize the private sector through the sale of low cost seedlings</li> </ul>

if not impossible for private nurseries to compete effectively. Thus, we conclude that:

- **The state should continue to produce low-cost seedlings since this activity is closely tied to the state's overall responsibility for forest management.**

At the same time, we question whether it is necessary for the state to dominate as supplier of seedlings for private use. We think that the state should reexamine its role periodically, and perhaps meet public demand while only supplementing private supply. Private nurseries told us that are eager to produce seedlings, but demand for their products has been stifled by the state's large supply of lower-cost seedlings. In our opinion, it is important for the state to recognize that its interests extend also to promoting rather than discouraging the development of private tree growers.

## Printing

Historically, Minnesota's printing service has been plagued by inefficiencies including high prices, poor quality, and time delays.<sup>30</sup> In response, the Legislature and the Department of Administration have undertaken various corrective measures over the years.

Since its most recent reorganization in 1988, printing services have been located within the print communications division of the Department of Administration. Currently, the division employs about 115 people and is divided into five major work units: (1) Printing Services, (2) Marketing, Distribution, and

<sup>30</sup> See Loaned Executive Action Program, *Final Report* (1972); Governor's Task Force on Waste and Mismanagement, *Final Report* (1978); and Council of State Governments, *Examination of Minnesota's Printing and Duplication Services* (Lexington, Kentucky: 1979).

Retail Sales, (3) Central Mail, (4) Information Systems, and (5) Planning and Financial Services. The Printing Services Unit subsequently has aggressively tried to address the aforementioned problems by working closely with state agencies and nonstate printers who provide most of its services, surveying customers' satisfaction, and identifying printing costs in detail.

Besides printing, we found the division has two other important functions. First, it reviews documents generated by the various state agencies and, to some extent, controls the content of printed materials. For example, agency materials cannot advertise or promote individuals.<sup>31</sup> Second, the Legislature has enlisted the department to help with economic development and recycling goals. Most notably, the state has pioneered the use of ink made from soybean oil by a Minnesota company, and has led the way for agencies which now must increase their use of recycled paper.<sup>32</sup>

**Nonstate  
printers  
already handle  
most state  
agencies' large  
jobs.**

The Printing Services Unit also manages almost all state agencies' printing jobs. A customer services representative is assigned to each agency, and the representative helps the customer-agency to specify what is needed in technical terms and what it would cost. The unit has a creative services area to provide graphic design, typesetting, keylining, electronic output, and various pre-press services. The print shop itself runs for two shifts daily and is small-to-medium by industry standards, with about 45 fulltime staff. In addition to offering multi-colored printing, the shop cuts, folds, collates, stitches, drills, binds, and wraps products. Finally, the unit provides copying services centrally and at three satellite locations.

When printing jobs exceed the state's facilities and capabilities, the Printing Services Unit solicits bids from private printers or gives the work to overload printers who are on contract with the state. As a result:

- During fiscal year 1990, most large printing jobs were done by nonstate printers who won the business competitively or agreed to do state printing at set prices.

As shown in Table 3.10, the state sent most of its large printing jobs elsewhere during fiscal year 1990. In contrast, it filled numerous small orders (71 percent of the printing jobs) at an average cost of \$610. Nonstate firms filled only 29 percent of the orders, but their average cost per job was \$3,811.

To obtain price comparisons for specific items, we sent examples of four finished documents (a bound report, questionnaire, brochure, and flyer) with detailed, written specifications to the Printing Services Unit and all 101 St. Paul area printers who were listed in the Yellow Pages in June 1991.<sup>33</sup> In each

<sup>31</sup> Department of Administration, *Standards and Guidelines for Printing and Publications* (September 1989).

<sup>32</sup> Minn. Stat. §16B.121 through 16B.125.

<sup>33</sup> To reduce the burden of estimating, we asked private printers their prices to print the flyer and one of the other documents. Thirty-one private printers sent estimates for the flyer. The report was too difficult for many printers, and only five sent estimates. Fourteen sent estimates for the brochure, and 10 for the questionnaire.



**Table 3.10: State Printing Order Dispositions**

	Number of <u>Orders</u>	<u>Percent</u>	<u>Dollar Value</u>	<u>Percent</u>	Average Dollar Value <u>Per Order</u>
State	5,773	71%	\$3,522,794	28%	\$610
Nonstate					
Overload	1,126	14	1,426,476	11	1,267
Bid Out	<u>1,232</u>	<u>15</u>	<u>7,559,286</u>	<u>60</u>	<u>6,136</u>
Total Private	2,358	29	8,985,762	72	3,811
All Printing Orders <sup>a</sup>	8,131	100%	\$12,508,556	100%	\$1,538

Note: Percents may not total due to rounding.

Source: Department of Administration, fiscal year 1990.

<sup>a</sup>Excludes copy center activities.

case, we asked for the price for a certain quantity within a specified time period, as described in Table 3.11.

Results of our state versus private price comparison showed that:

- The state's prices for printing were low when compared with private printers in St. Paul last summer.

**Table 3.11: Estimated Price for Printing by the State Versus Private Firms**

<u>Job</u>	<u>Specifications</u>	<u>State Price Per Job</u>	<u>State Price Per Copy</u>	<u>Private Price Range Per Job</u>	<u>Private Price Range Per Copy</u>	<u>Median Private Price Per Job<sup>a</sup></u>	<u>Median Private Price Per Copy</u>
Single-sheet flyer	5,000 copies, 3 days, good quality, 1 page	\$181.09	\$0.04	\$149.50- 367.00	\$0.03-0.07	\$245.00	\$0.05
Folded brochure	10,000 copies, 5 days, premium quality, 4 pages	1,821.66	0.18	1,445.60- 2,605.00	0.14-0.26	1,807.50	0.18
Saddle-stitched questionnaire	500 copies, 5 days, good quality, 8 pages	149.46	0.30	178.96- 460.00	0.36-0.92	259.50	0.52
Perfect-bound report	1,000 copies, 10 days, good quality, 118 pages	3,443.35	3.44	4,354.86- 6,000.00	4.35-6.00	4,570.00	4.57

Source: Office of the Legislative Auditor, 1991.

<sup>a</sup>Medians are based on written estimates from at least five St. Paul printers in June 1991, and do not include sales tax which applies to private estimates only. When the Department of Administration sends printing jobs to nonstate printers, agencies are charged sales tax. The department does not charge sales tax on in-house printing jobs.

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**State printing prices were generally lower than private firms'.**

As shown, state prices were substantially lower than private firms might have charged an agency shopping on its own. Private firms' prices ranged from about 1 percent lower to about 74 percent higher than the state's prices.<sup>34</sup> However, the estimates from private firms varied widely, and some came close to the state's prices. For example, private firms' prices ranged from \$1,446 to \$2,605 for 10,000 folded brochures and from \$149 to \$367 for 5,000 single-sheet flyers while the state's prices were \$1,822 and \$181 respectively. Private estimates for printing 500 copies of our questionnaire ranged from \$179 to \$460 while the state estimated \$149.

The Department of Administration periodically surveys private rates for a wide variety of services, and its results suggest that the state's printing rates were about 45 percent lower overall in fiscal year 1991.<sup>35</sup> However, the department noted that private printers were reluctant generally to disclose their rates which depend on many factors, including quality, service levels, plant capacity, and market conditions. In our conversations with private printers last summer, they indicated that depressed market conditions could have affected their estimates.

We asked department officials whether state prices adequately covered costs and learned that:

- **Most of the department's rates for various printing-related services were set too low during fiscal year 1991.**

The Department of Administration has instituted a complex pricing system based on projected volume and 21 various activities and services which may be required to produce documents, and actual costs were higher in 14 cases. Because agencies' demand for individual services varied, the department's rates overall were 1.1 percent lower than its actual costs to provide specific services during fiscal year 1991, and operating expenses exceeded sales income by 1.5 percent.<sup>36</sup> Also, the Governor's attempt to improve the state's poor financial condition by directing agencies to reduce budgetary spending resulted in fewer printing orders during the last quarter of fiscal year 1991.

In the past year or two, the Department of Administration has taken some action to improve its finances. For example, rather than hire permanent staff, it has contracted with an employment agency to provide labor for peak workloads. Also, it has kept more work in-house, partly because it has become more willing and able to do some complex jobs itself. Finally, the division is planning to move to a new facility which, according to the department, will permit it to use space more efficiently and may increase productivity.

Figure 3.6 shows our analysis of the overall costs and benefits of the state's print shop. On the positive side, the shop provides about 45 fulltime jobs with

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<sup>34</sup> Private prices do not include sales tax, and the sales tax does not apply to state printing done in-house.

<sup>35</sup> Department of Administration, *FY92 Proposed Rate Package*, Printing Services (undated).

<sup>36</sup> Department of Administration, *FY92 Proposed Rate Package* (undated).

**Figure 3.6: Benefits and Costs of State-Operated Printing Shop**

	Individual	Department or Community	State or Public
<b>Benefits</b>	<ul style="list-style-type: none"> <li>• Employs state workers with full benefits</li> </ul>	<ul style="list-style-type: none"> <li>• Provides special assistance to state agencies</li> <li>• Fosters expertise in purchase of printing services from the private sector</li> </ul>	<ul style="list-style-type: none"> <li>• Promotes economic development through use of new products</li> <li>• Fulfills legislative requirements</li> <li>• Helps to exert financial, legal, and ethical control over state agencies</li> </ul>
<b>Costs</b>	<ul style="list-style-type: none"> <li>• Deprives private sector of opportunity to profit</li> </ul>	<ul style="list-style-type: none"> <li>• Restricts state agencies' choice of printers</li> <li>• Forces state agencies into captive relationship with state printing staff</li> <li>• Duplication of services</li> <li>• Requires bureaucratic paperwork, forms, and procedures</li> </ul>	<ul style="list-style-type: none"> <li>• Inflates the size of state government</li> </ul>

full benefits. On a larger scale, it has promoted economic development and developed special expertise within the Department of Administration. Also, it exerts needed financial, legal, and ethical control over the content of agencies' printed materials. On the negative side, the print shop deprives private firms of the opportunity to do more state business, and it inflates the size of state government.

Based on price and other considerations, we concluded that:

- **Subject to price corrections, the state's practice seems reasonable and may prevent excessive dependence on the private sector.**

Since the print shop is small-to-medium in size by industry standards and its prices must be adjusted annually, we think that its advantages outweigh its disadvantages. Possibly, over time the print shop could be reduced in size or phased out since the shop itself is not vital to the Department of Administration's mission.

However, it is important to recognize that the state's printing expenditures probably would not decrease if the print shop were eliminated or dramatically reduced in size. The number of state employees could be reduced, but we think that it makes sense for agencies to channel complex printing jobs through experts who are trained to economize, review documents, and negotiate with contractors. As we showed in Chapter 1, state contracts can present difficulties for inexperienced agencies.

## Computer Programming and Systems Analysis

Government information services have changed rapidly over the last decade. With the advent of mini- and microcomputers, state agencies' abilities to develop and maintain their own information systems have flourished. At the same time, the state has redefined responsibilities for overseeing, developing, managing, and operating information technology.

Previously, most information systems and related functions were centralized in the Department of Administration's Information Services Bureau (now known as the InterTechnologies Group or simply InterTech). It administered information policy, developed information systems for state agencies, and operated the state's data center. Now, a separate office sets policy, state agencies are largely responsible for developing new systems, and InterTech's main role is to maintain hardware, communications, and existing information systems.

Over time, state agencies have come to rely less on InterTech and more on their own or contract employees for computer programming and systems analysis. Today, the Applied Computing Technologies Unit employs nine staff but manages contracts for approximately \$5 million annually in services from 60 fulltime equivalent workers who generally work on site at agencies.

We focused our cost comparison on routine computer programming and systems analysis because contractors perform essentially the same work as the nine state employees. In fact, state and nonstate employees sometimes work together on the same projects.

When agencies need help with minor program revisions or other small computer projects, they first specify the particular skills and estimate the time needed to do the job. At this point, agencies can: (1) independently hire contractors following a similar process as described in Chapter 2, (2) obtain workers through InterTech's pre-established overload contracts, or (3) use one or more of the nine state workers in the Applied Computing Technologies Unit.<sup>37</sup>

According to the Department of Administration, private contractors accounted for most of the Applied Computing Technology Unit's work hours (89 percent) during fiscal year 1991, while its own employees comprised 11 percent. At the same time, the unit's programmers and systems analysts resemble contractors more than state employees. InterTech charges agencies to use their services, and the workers have few if any routine responsibilities to InterTech itself.

If a state agency chooses a computer programmer or systems analyst who is employed by a contractor rather than the state, the Department of Administration adds a \$1.00 to \$3.00 hourly surcharge to the agreed-upon hourly rate.<sup>38</sup>

<sup>37</sup> InterTech may assign other computer programmers and systems analysts to agencies for non-routine projects.

<sup>38</sup> The actual amount of the surcharge is based on the extent to which an agency relies on the contractors.

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**About 60  
programmers  
and systems  
analysts did  
routine work  
for state  
agencies  
through  
contracts.**

The surcharge is intended to cover the department's costs to negotiate and administer the contracts. In return, agencies save considerable time and effort by not having to go through the advertising and negotiating process themselves.

To compare the average hourly rates for computer programmers and systems analysts, we interviewed supervisors and managers at InterTech and reviewed written materials. We also wrote to contractors who recently worked for the state and questioned them about their rate structure. We then compared hourly wages for contract employees with the state's rates for employees who perform the same type of work. Finally, we asked whether the state's rates were adequate to cover costs.

Table 3.12 compares state and private rates for computer programming and systems analysis services. As these data indicate:

- During fiscal year 1991, the state's rates were higher than its private contractors.

**Agencies paid artificially low rates for state-employed programmers and systems analysts.**

**Table 3.12: State and Private Contractor Hourly Rates for Senior Computer Programmers and Systems Analysts**

	<u>Private<sup>a</sup></u>	<u>State</u>
Senior Computer Programmers	\$27.50-36.00	\$38.00
Senior Systems Analysts	\$35.00-46.00	\$47.00

Source: Department of Administration, fiscal year 1991.

<sup>a</sup>The Department of Administration charges agencies an additional \$1 to \$3 beyond contractors' hourly rates to offset its contract administration costs.

The state's official rates were \$38 per hour for computer programmers and \$47 per hour for senior systems analysts. In contrast, private contractors' hourly rates ranged from \$27.50 to \$36.00 for programmers and \$35.00 to \$46.00 for senior systems analysts.

Despite the state's higher rates, we found that:

- The state's rates were too low to cover the computer programmers' and systems analysts' share of indirect costs at InterTech.

As a result, the Department of Administration projects that its Applied Computing Technologies Unit will lose approximately \$30,000 during fiscal year 1992. Staff calculated that programming and systems analysis rates would have to be 13 and 40 percent higher than the respective 1991 rates to cover InterTech's costs--putting state rates even higher than private sector rates. However, InterTech has already raised its rates considerably over the last few years, and large, additional increases could be hard for agencies to accept.

Instead, we learned that the unit manager added a temporary state employee to the unit specifically to bring in more revenue and raised fiscal year 1992 rates for state workers by two dollars.

A June 1991 study which was commissioned by InterTech shows that its indirect costs are inordinately high compared with similar public and private operations across the nation.<sup>39</sup> Our own correspondence with contractors showed that:

- **Overhead costs accounted for a higher proportion of the state's hourly rate during fiscal year 1991 than for private contractors.**

We calculated that overhead charges accounted for 28 percent of the state's hourly rates. In contrast, overhead for private contractors ranged from 18 to 26 percent of hourly rates, and profit was 0 to 12 percent.

In our opinion, according to the data collected by KPMG Peat Marwick, InterTech as a whole is inefficient. As Table 3.13 shows, similar public and private data centers across the nation were staffed 37 percent lower than InterTech's data center, which makes up about two-thirds of InterTech's entire operation. Overall costs in other data centers were over 18 percent lower than InterTech's, due chiefly to lower personnel expenses.

**Table 3.13: Staff and Costs at InterTech's Data Center Versus National Norms**

	<u>InterTech</u>	<u>National Norm</u>	<u>Percent Difference: InterTech- National Norm</u>
<b>Staff Headcount</b>			
Technical Services	23	19	17%
Operations Support	78	32	59
Direct Operations	26	43	-65
Administration and Clerical	27	7	74
Management and Planning	36	18	50
Total	191	120	37%
<b>Data Center Costs</b>			
Technology	\$9,621,000	\$9,053,000	6%
Personnel	8,024,000	5,369,000	33
Processing	5,063,000	4,080,000	19
Disk Storage	1,471,000	2,114,000	-44
Software	1,834,000	1,289,000	30
Total	\$17,645,000	\$14,422,000	18%

Source: KPMG Peat Marwick, 1991.

Note: Totals may not add up due to rounding.

<sup>39</sup> KPMG Peat Marwick, *Cost and Services Management Study: Frameworks for Managing Information* (Minneapolis, June 1991).

We understand that indirect costs are a source of dispute within the department and that it currently anticipates making major changes, to some extent to keep state agencies from taking their business to private firms. Partly in response to the study, the Department of Administration is diligently reviewing InterTech's structure and activities in an effort to clarify and then effectively carry out its mission. The department hopes to complete its review by spring of 1992.

Figure 3.7 summarizes our analysis of the major costs and benefits of the state employing its own computer programmers and systems analysts. On the positive side, state employees bring in some revenue to help cover high overhead expenses, while providing direct services at agencies' request. On the other hand, the unit has not set its rates high enough to cover the indirect costs associated with its workers, and its high costs represent inefficiency.

**Figure 3.7: Benefits and Costs of Routine State Computer Programming and Systems Analysis Service**

	Individual	Department or Community	State or Public
<b>Benefits</b>	<ul style="list-style-type: none"> <li>• Employs state workers with full benefits</li> </ul>	<ul style="list-style-type: none"> <li>• Brings in revenue helping to cover high overhead</li> <li>• Provides management information about agencies' computer activities</li> <li>• Fosters continuity of support service to state agencies</li> <li>• Responds to agencies' needs</li> </ul>	<ul style="list-style-type: none"> <li>• Helps to provide some centralized control over agencies' data systems</li> <li>• Helps to provide some oversight over contractors' work</li> </ul>
<b>Costs</b>	<ul style="list-style-type: none"> <li>• Deprives private sector of opportunity to profit</li> </ul>	<ul style="list-style-type: none"> <li>• Helps to maintain department inefficiency</li> <li>• Rates do not cover all indirect costs</li> <li>• Duplication of services</li> </ul>	<ul style="list-style-type: none"> <li>• Places costly burden on state government</li> </ul>

Thus, we conclude that:

- Because state prices are not competitive with private sector rates for similar, routine computer programming and systems analysis services, there is little apparent need for the state to continue selling its employees' services.

It seems to us that the current, small number of state employees could be further reduced without affecting agencies' ability to obtain needed, routine programming and systems analysis. However, the department may need to keep some staff in the unit because it has some responsibility for negotiating and administering contracts for the same services.

Unfortunately, the unit has not done a good job of contract management in the past.<sup>40</sup> InterTech acknowledged to us that staff have not monitored contractors aggressively but emphasized that changes are underway. For example, the Department of Administration assigned a new manager to the Applied Computing Technologies Unit in July 1991, partly to improve the contract management process. Also, a 1990 draft of the Applied Computing Technologies Unit's responsibilities regarding contractors and customer agencies specifies that project leaders should be attending status meetings, providing project leadership assistance, resolving problems as needed, and evaluating contract employees.<sup>41</sup> However, the document has not been finalized, so responsibilities are unclear.

Recently, the Information Policy Office showed that the unit's lack of monitoring contributed to major cost overruns at one small agency.<sup>42</sup> Likewise, contract reviewers within the Department of Administration had to intervene when contractors complained about the way in which the Applied Computing Technologies Unit selected contractors last summer. From our perspective, InterTech should ultimately be responsible for the work performed under the contracts which it negotiates and should more carefully monitor contractors' performance and agencies' satisfaction, although state agencies also must take responsibility.

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**More state activities could be provided by contractors, but the potential for added cost savings is low.**

## SUMMARY

As a result of our comparisons and contract analysis, we believe that some additional state activities could be provided by the private sector or other units of government with little harm and some benefit. However, the potential may not be great. As we have seen, using state employees is more expensive than alternatives in some cases, and less expensive in others. Moreover, costs to agencies may be transferred and may not include increased expenses for planning or monitoring, activities which we think are needed.

Further, it is difficult to estimate the true costs and benefits of state-delivered services versus alternatives. State costs may not reflect all expenses accurately and may fluctuate on a yearly basis. Also, contractors' prices may be set artificially low or high. At the same time, cost is not always the only appropriate criterion for comparison. A portion of the costs for state services may go toward important policy objectives which may not be readily apparent, such as economic development and affirmative action. In other cases, the state must continue to perform some governmental functions such as policy making, regardless of the cost.

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<sup>40</sup> The Financial Audit Division of our office has found overpayments and weak control of contracts for computer programming and systems analysis. See Office of the Legislative Auditor, *Department of Administration Financial Audit for the Year Ended June 30, 1990* (April 1991).

<sup>41</sup> Department of Administration, *Draft of Applied Computing Technologies Unit Project Leader's Responsibilities* (December 1990).

<sup>42</sup> See Department of Administration, *Board of Medical Practice Licensing and Discipline Information System* (November 1991).



In general, we think that the state should routinely collect the data necessary to price its services, compare its costs with private sector prices, and determine the overall costs and benefits of alternatives. This is especially important when both the state and private sector provide essentially the same services. To some extent, the state has been doing this in areas such as printing, computer programming and systems analysis, and tree seedlings, but its efforts have not always been successful.

In the following chapter, we synthesize our research and present some guidelines which may be useful in deciding how the state should deliver new services. Despite administrative difficulties with state contracts for printing and computer programming and systems analysis, we think that the Department of Administration, with some improvements to its data base, may be able to suggest whether some other services which are needed by multiple agencies could be better handled centrally rather than agency by agency.

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# OVERVIEW AND CONCLUSIONS

## Chapter 4

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**A**s illustrated in this report, Minnesota's recent experiences with professional/technical contracts lend little support to the idea that simply increasing the use of nonstate workers could reduce government expenses and materially improve public services. Contracting is already common in Minnesota, but contracts are not always processed and managed efficiently and effectively. Also, the state has provided some services with little attention to the costs and benefits of contracts or other alternatives.

This chapter addresses the following questions:

- What are the major problems facing or caused by state agencies as they contract for professional/technical services?
- What can the state do to increase the likelihood that contracts or other alternatives will be used more effectively in the future?

Below we summarize the state's past problems with contracting and and its own service delivery, and make some recommendations which might increase government productivity.

## REASONS FOR CONTRACTING PROBLEMS

In our opinion, the contract-related inefficiencies which we identified during the course of our research flow from five general problems. These are:

- inadequate information on the relative costs and benefits of providing services with state employees versus alternatives,
- sketchy guidelines and complex procedures for state agencies,
- inefficient contract review and approval,
- weak management by some agency staff, and
- lack of a state strategy for contracting or using other alternatives.

**The  
Department of  
Administration  
needs to  
balance its  
responsibilities  
to regulate and  
serve state  
agencies.**

In general, we think that the Department of Administration needs to strike a more effective balance between its statutory responsibilities to regulate and provide services to agencies. In the past, the department has downplayed its control functions in favor of customer service, which has contributed to many of the problems cited above. In addition to exerting greater control over present activities, we think that the department must be more proactive in suggesting how state services should be aligned in the future. The department needs to focus more attention on the costs and benefits of providing services through state employees versus alternatives. Simply using more contracts or other alternatives is not a panacea for reducing the cost of government; nonstate employees are sometimes cheaper and other times more expensive than state workers.

Below we discuss each of the above problems and suggest methods for improvement.

## **Inadequate Information**

In our study, we found that agencies sometimes lacked cost data which they would need to make informed decisions, while other agencies had data but did not price their goods and services on full costs. We think that agencies should track what their services or programs cost. If they did, they could routinely compare the monetary and nonmonetary costs and benefits of obtaining services through various mechanisms, which could lead to greater efficiency in state operations.

Minnesota statutes already require some agencies to price their services to cover costs. For example, the Department of Natural Resources' prices for tree seedlings are supposed to cover its stock and distribution expenses, and the Department of Administration's rates for computer services and printing are expected to cover its costs.<sup>1</sup> We think that this type of legislation should be expanded to other agencies and services.

## **Sketchy Guidelines and Complex Procedures**

Minnesota's contracting policies yield little insight into circumstances where contracting may be appropriate or in the public's best interest. As we showed in Chapter 2, the Department of Administration provides some written guidance on inappropriate uses of professional/technical contracts. However, agencies can quite easily obtain diverse services and are generally responsible for the results. Further, some of the state's restrictions may be unrealistic and impossible to enforce at the present time.<sup>2</sup>

<sup>1</sup> *Minn. Stat.* §89.37 and *Minn. Stat.* §16B.48, Subd.4.

<sup>2</sup> Like Minnesota, the federal government has guidelines focused exclusively on inappropriate contracting. The Office of Management and Budget has guidelines for advisory and assistance contracts, but they have been difficult to apply. See Memo from Office of Management and Budget to the Heads of Executive Departments and Establishments, *Guidelines for the Use of Advisory and Assistance Services*, Washington, D.C., January 4, 1988.

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**Agencies need better guidance on when and whether to contract.**

We hope that the department will consider adding some positive guidance to its official manual and be of greater assistance to agencies which are considering contracts. For example, task forces and policymakers in Oregon and Colorado have identified circumstances where contracts would be appropriate, successful, and partially substitute for state employees.<sup>3</sup> We recommend that:

- **The Department of Administration should develop guidelines to help agencies identify circumstances conducive to using professional/technical contracts.**

Such guidelines could require agencies to conduct feasibility studies periodically which would estimate the potential costs and benefits of contracting for state services. At the same time, such studies could help state agencies sort out their own priorities and deficiencies.

First, agencies could establish a rationale for providing some services in-house rather than obtaining them elsewhere. Based on our study and a review of other state and federal guidelines, such a rationale for not contracting for services might include the following elements:

- **It takes little time for employees to provide the services as part of or in addition to their routine activities.**
- **The state has already made a significant investment in facilities or equipment which has not outlived its usefulness.**
- **The activity is closely tied to the agency's distinctive objectives.**
- **The activity helps to run the agency, especially by generating revenue or reducing costs.**

Under circumstances such as these, state agencies might justifiably use state employees to provide services which are also available on the open market. For example, state tree nurseries are closely tied to the state's responsibility for forest management, and low cost seedlings may encourage greater public reforestation efforts which are ultimately good for the state and its economy. Likewise, seasonally raising fish is only a small part of the state's responsibility for fish management, while fishing is vital to tourism. And there are financial and technical justifications for state sales of motor vehicle registrations and state print shop operations.

On the other hand, we think that state agencies should not continue to provide services in-house or with contractors merely because it is customary to do so. We recognize that it is always difficult to change, but it can also be costly to provide the same services year after year, regardless of changes in technology and the marketplace. State-operated nursing homes are one case in point. Since Minnesota has a large, well-regulated nursing home industry throughout

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<sup>3</sup> The Council of State Governments, "Privatization and Contracting for State Services: A Guide," *Innovations* (April 1988) and Colorado Office of State Auditor, *Privatization in Colorado State Government* (Denver, March 1989).

the state, it may be less costly to use it than to provide services in large, state-operated facilities. Also, we think that state agencies should contract for routine computer programming and systems analysis services instead of using Department of Administration employees whose services are sold below cost.

Second, when state agencies are considering ways to provide new services, they could consider professional/technical contracts in the following circumstances:

- **The workload or funding is likely to vary.**
- **New, high technology equipment, highly specialized personnel, or significant capital investments are needed.**
- **Service sites must be scattered throughout the state.**
- **Others could reasonably be expected to match or surpass the value and service levels which state employees could provide.**

Currently, Minnesota statutes authorize the Commissioner of Administration to study state agencies' organization and management to ensure their efficient and effective operation.<sup>4</sup> In carrying out this responsibility, we think that the department and other state agencies should keep these and the preceding considerations in mind and routinely weigh state programs and services against the alternatives.

## **Inefficient Contract Review and Approval**

**The contract review and approval process is inefficient.**

While state agencies often create their own contracting problems, we found that the contract review and approval process itself is well-intentioned but poorly implemented. For example, the Department of Administration has attempted to review a staggering number of contracts and related documents with few staff, no extra resources during peak periods, and no priorities besides those which agencies occasionally demand.

As we noted in Chapter 2, the Department of Administration usually handled all contracts in chronological order of receipt although they varied in value from \$80 to \$68 million during our study period. Although it obtained legislative approval to streamline the process by raising the dollar limit for some of its reviews and dropping its responsibility to gather evaluations concerning contractors' performance, the department has not pressed agencies to handle their own small contracts internally despite the availability of a mechanism to do so.<sup>5</sup>

In Chapter 2, we made several recommendations which would allow the department to focus most intently on contracts which are valued above the

<sup>4</sup> Minn. Stat. §16B.04, Subd. 2 (4).

<sup>5</sup> Minn. Laws (1990), Chapter 572, Sections 2 and 3.

\$10,000 median. If implemented, this recommendation could substantially reduce delays for state agencies and free staff to formally train program managers, update the state's official manual on professional/technical contracts, thoroughly review contracts, and enforce contracting policies and procedures.

We hope that the Department of Administration will delegate some of its specific authority to qualified individuals within good-performing agencies as the Attorney General's Office has done and the Department of Finance plans to do. However, as we recommended in Chapter 2, all reviewing agencies (the Departments of Administration, Finance, and Employee Relations, and the Attorney General's Office) need to better coordinate their activities and reduce duplication of their efforts.

## Weak Management

As discussed in Chapter 1, state agencies sometimes exercise weak control over contractors, and they have created problems for themselves and others involved in the contract review and approval process. During the course of our research, we found cases where agencies needed contractors' work, but program managers barely understood it. Since program managers use contracts most frequently to obtain special expertise, this leaves considerable potential for contractors to abuse their positions and for agencies to lose control.

At the other extreme, some agencies neglected to specify contractors' duties in detail. In our opinion, it does not follow that contractors' willingness and ability to provide some services mean that the services are needed or desirable. As noted in Chapter 1, one agency permitted its contractor simply to specify how it would spend \$2 million. In other cases, agencies have allowed contractors to manage programs, employees, and publications although this is contrary to the Department of Administration's guidelines for professional/technical contracts.

In general, we think that state agencies should retain or develop an ability to specify, direct, monitor, and independently evaluate contractors' work. The law already requires agencies to diligently administer and monitor contractors' performance, and agencies must assign specific staff to serve as liaisons to contractors.<sup>6</sup> However, the Department of Administration provides little oversight or guidance regarding agencies' internal monitoring systems.

Unfortunately, the program managers' enthusiasm over the freedom associated with reliance on contract workers suggests to us that they may be neglecting some important aspects of their own employees' performance. Further, some agencies reported using professional/technical contracts to circumvent their legal obligation to fully utilize the civil service system. The Legislature rather tightly controls money for salaries, but exercises less control over money for contractors. However, we recognize that there is currently no inventory of

<sup>6</sup> *Minn. Stat.* §16B.06, Subd. 3 and *Minn. Stat.* §16B.17, Subd. 3(6).

state employees' skills which might help agencies determine whether any state workers may be able to perform the needed services.

In addition, we noted that some agencies do not pay close attention to the cost of their own services, even when like services are also available privately. As we discussed in Chapter 3, state agencies sometimes have provided or priced their services with little attention to costs or alternatives.

## **Lack of a State Strategy**

Currently, the Department of Administration exercises little or no authority over the content of state agencies' contracts, rarely disapproves them, and has no knowledge whether contracts are ultimately used. The department has a computerized data base, but it uses data mainly just to generate lists of selected, approved contracts. Moreover, we found that no system exists to disseminate information agency-wide about the products and services actually delivered under contracts and agencies' satisfaction with individual contractors. Since the department no longer requires agencies to submit evaluations of contractors' performance, we recommend instead that:

**Policymakers  
need better  
information  
about contracts  
by state  
agencies.**

- **Along with the Department of Finance and the Attorney General's Office, the Department of Administration should develop a joint data base which would permit them to monitor the progress and purpose of professional/technical contracts.**

As noted in Chapter 2, the Department of Administration is primarily responsible for contract review and management, but it does not routinely compile specific information on the number and value of professional/technical contracts by year, the length of time to review contracts and the problems uncovered, or the number and type of contracts received from agencies. In our opinion, the department and policymakers need basic information such as this to better define the role of contracting within state government. Also, the department could use improved data to delegate some of its responsibilities to individuals within good-performing agencies. Considering the state's continuing financial problems, such information would be especially helpful at this time.

In our opinion, the Department of Administration would improve the contract review and approval process if it implemented the recommendations which we set forth in Chapter 2. In addition, we think that:

- **The Department of Administration could help by further encouraging state agencies to evaluate and manage their operations as efficiently and effectively as possible.**

To keep up with changes in the marketplace, we think that state agencies should periodically review whether their services are still needed and then how best to deliver them. The department could develop a general strategy for service delivery which would help agencies determine whether their present methods of obtaining services are cost-effective. The Commission on Reform

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**The  
Department of  
Administration  
should analyze  
and prioritize  
the contracts it  
reviews.**

and Efficiency also may prod agencies to review and justify their services as it examines ways to restructure state government over the next few years.

Finally, we think that, with an improved data base, the Department of Administration may be able to further reduce its workload and the administrative burdens of individual agencies. Since the department would have information on all state agencies' larger contracts, it would be in the best position to identify multiple contracts for the same types of services from various agencies.

As we explained in Chapter 3, most routine computer programming and printing contracts already are negotiated by the Department of Administration on behalf of all state agencies. Properly administered, such centralization could streamline agencies' duplicative searching for contractors. Thus, we suggest that the Department of Administration should identify additional services which could be handled centrally and then determine whether it would be better to deliver services through state employees, contractors, or some combination. If there was enough demand across state agencies for similar, routine services, it is possible that state employees could provide the needed services cost-efficiently. If not, one agency could negotiate a variety of contracts which would be available when or if agencies needed them.

Specifically concerning training classes, we noted that the Department of Employee Relations is statutorily responsible and offers many of the same titles as indicated on contracts. Currently, the Department of Employee Relations is developing an approval process for agency-sponsored general management training, whether done in-house or by consultants, which could reduce duplication and possibly save money. However, we are concerned that the new, additional procedures will make the existing review and approval process even less efficient. We hope that the Department of Employee Relations will coordinate its activities with the Department of Administration and consider centrally negotiating, administering, and monitoring training contracts for classes such as communications, stress management, and decision making.

Despite our general suggestion that the Department of Administration should further centralize contracts for some widely used services, we emphasize that professional/technical contracts for agency-specific services often can be managed only by individual agencies. When agencies' substantive areas of responsibility or central goals are involved, program managers must be intimately involved in negotiating, administering, and monitoring contracts.

## SUMMARY

Our study suggested that professional/technical contracts can be costly and risky. However, current review and approval procedures are so inefficient that they hamper agencies' ability even to contract for routine services. In such cases, we think that state agencies should be given greater responsibility, training, and authority to ensure that public monies are well spent. For agencies'

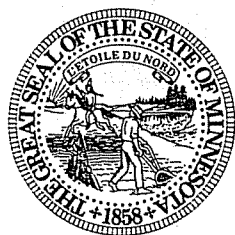


large, complex contracts, we think that a detailed review and approval process which involves responsible officials outside the agencies is generally a good idea.

If state agencies' internal procedures were strengthened, delays could be reduced and there would be substantially less demand on the formal review and approval process. This would give Department of Administration staff time to improve its manual, develop more useful guidelines, and train agency staff. However well-intentioned, the procedures now are unnecessarily cumbersome and could be better managed. In our opinion, legislative and administrative changes should be made to encourage all state agencies to focus their attention on the most appropriate and effective methods of obtaining services, whether by contract, state employees, or other alternatives.

Department of  
Administration

February 5, 1992



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(612) 296-3862

Mr. James R. Nobles  
Legislative Auditor  
Office of the Legislative Auditor  
First Floor Veterans Service Building  
20 West 12th Street  
Saint Paul, Minnesota 55155

Dear Mr. Nobles:

This letter is to serve as the Department of Administration's response to the audit of State Contracting For Professional/Technical Services conducted by the Program Evaluation Division of your office, to be presented to the Legislative Audit Commission on February 14, 1992.

It is the position of the Department that this analysis can serve not only to educate the Commission, but also to provide opportunities to provide better service to our state government customers. For this reason, the Department is grateful to the Commission for allowing this comprehensive review to be undertaken by the Legislative Auditor.

The Department's response is divided into the three areas examined in the audit relative to the Department: professional/technical services provided by the Applied Computer Technologies Unit of the InterTechnologies Group; professional/technical printing services provided by the Print Communications Division; and the administration of professional/technical contracts by the Materials Management Division.

Professional/Technical Services provided by the Applied Computer Technologies Unit

In October 1990, the Department engaged KPMG Peat Marwick to conduct a benchmark Cost and Services Management Study (CSMS) of its computer operations. The Applied Computing Technologies Unit (ACT), referenced in this audit, was not included as part of that study, although the aggregate cost conclusions from the study were applied to ACT. Based on the results of the CSMS, InterTech embarked on a major, comprehensive refocusing exercise in September 1991. This effort, about 75 percent complete at this time, includes a complete analysis of customer, stakeholder, employee, and managerial issues. The product of the refocusing is expected to be the establishment of a clear mission for InterTech, along with an effective and efficient structure designed to support and implement that mission.

Architectural Design

Building Code

Building Construction

Contracting

Data Practices

Data Processing

Employee Assistance

Energy Conservation

Fleet Management

Information Management

Inventory Management

Local Government Systems

Management Analysis

Plant Management

Printing &amp; Mailing

Public Documents

Purchasing

Real Estate Management

Records Management

Resource Recycling

State Bookstore

Telecommunications

Volunteer Services

Therefore, the Department generally supports the findings of the audit and anticipates significantly improved service and competitive pricing for its customers in the very near future as a result of this refocusing activity.

Professional/Technical Printing Services provided by the Print Communications Division  
The Department takes pride in the findings of the audit indicating that its printing operation is a cost-effective option for state agencies to meet their printing needs.

Furthermore, the Department recognizes the dynamic nature of printing technology and continues to change in order to better service the needs of its customers.

Administration of Professional/Technical Contracts by the Materials Management Division

The audit discusses this issue at considerable length, focusing primarily on service-related issues. Our response, however, addresses both service and statutory concerns.

Statutory:

The Department's role in this process, based on statutes, has been one of "advise and consent" to agencies seeking a professional/technical contract, rather than one of control or regulation. In this role, the Department ensures that the state not only obtains the best value for its purchases but also balances the societal needs prescribed by law, such as use of recycled products, the human rights compliance of businesses, and proportional purchases with small businesses. It has generally not been the role of the Department to determine the relative merits of a particular contracting need that an agency may pursue through contracting. For these reasons, the Department's role has been to add value to the professional/technical contract process by examining agency contracts for compliance with statutory requirements. This is an important distinction.

Service:

While the Department believes that it has been responsibly administering the professional/technical process, the audit does provide several areas of increased service opportunity that the Department intends to address in the future:

- \* Examine the workload requirements of the professional/technical contract review staff and adjust internal human and financial resources as necessary.
- \* Establish a more formalized, coordinated (and, thus, more efficient) relationship with the Department of Finance and Attorney General's office for professional/technical contract administration.
- \* Utilize the existing data base management system to better track, report, and process contracts.

Legislative Audit Response

February 5, 1992

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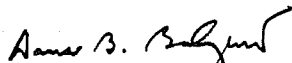
- \* Revise existing professional/technical contract procedures manual and update the manual as necessary.
- \* Establish routine and formalized training sessions for agencies.
- \* Consider further delegation of contract authority to qualified individuals within agencies who have demonstrated competence in the professional/technical contract administration area and a willingness to dedicate resources to the task.
- \* Through training, encourage agencies to properly plan for the fulfillment of their contract needs within the time constraints of the administrative process.
- \* Consider raising, on a pilot basis, the dollar limits on agency annual plans.

The Department does not, however, fully endorse the audit's recommendation to amend Minnesota Statute 16B.17, increasing the limit for prior approval from \$5,000 to \$10,000.

Although the recommendation would reduce the Department's contract workload, there is an apparent risk that statutory obligations for small business compliance and other public policy concerns may not be met. However, as the basic service issues identified above are implemented and addressed, the Department will re-examine this recommendation.

In conclusion, the Department found the audit findings were helpful in validating existing conditions and providing a useful tool for continued improvement of customer service.

Sincerely,



Dana B. Badgerow  
Commissioner  
Department of Administration

DBB/RAS

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