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Using competition for performance improvement : a resource for practitioners advising governments and not-for-profits

Michael A. Crawford

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AICPA

American Institute of Certified Public Accountants

The AICPA Government and Not-for-Profit Performance Improvement Series

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Crawford has provided consulting assistance to governments in planning for and implementing competition efforts, including performing cost analysis for alternative methods of service delivery or purchase of goods or capital assets. In addition, he supervises and participates in his firm's projects to perform internal audit activities for state and local governments that have elected to outsource their internal audit function.

Crawford is recognized both nationally and internationally as a frequent lecturer at many national and state government and not-for-profit conferences. Crawford is a certified public accountant and member of the American Institute of Certified Public Accountants (AICPA) and the Oklahoma Society of Certified Public Accountants (OSCPA). He is a past president of the OSCPA and past chairman of its governmental accounting and auditing committee, and he has been inducted into the Oklahoma Accounting Hall of Fame. Crawford has also been an AICPA Council member, Peer Review Committee member, and five-time recipient of the AICPA's Outstanding Discussion Leader Award.

Acknowledgments

The concepts and materials in this publication are applicable for use in all states and by all government and not-for-profit organizations. Although different approaches to introducing competition into government and not-for-profit organizations have been conceived, chapters 2 through 5 in this publication are based, in general, on the approach included in the Arizona Governor's Office for Excellence (OEG) *Competitive Government Handbook.* This approach is intended to be both comprehensive and easy to use. We are grateful to the OEG staff for their significant efforts in this area. (The OEG maintains a Web site at www.governor.state.az.us/excellence.)

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Introduction

Tremendous economic and societal pressures are compelling not-for-profit organizations and federal, state, and local governments to reevaluate their services and take new paths. Fierce competition for resources is forcing these organizations to continuously improve their processes and bottom-line results. In order to meet demands for services, privatization and process reengineering have become a necessity. The current environment opens new opportunities for CPAs to work with government and not-for-profit organizations on performance improvements. *Using Competition for Performance Improvement: A Resource for Practitioners Advising Governments and Not-for-Profits* is a step-by-step guide for working with both large and small not-for-profit organizations and governments that must determine whether to privatize, retain, or reengineer targeted functions or activities.

My own experience as director of Arizona's then largest state agency, the Arizona Department of Economic Security (DES), convinced me that introducing competition into government actually improved our own internal operations. I also found it essential in order to maintain the ongoing vitality of the organization. The agency had annual resources in excess of $2.6 billion, employed over 9,500 people, and included more than fifty human service programs, including public assistance, unemployment insurance, child support enforcement, and child protective services.

During my tenure as director, the agency privatized a number of functions, such as child support collections, a portion of child protective services, food stamp security, welfare-to-work programs, and the agency's central mailroom operations (see Case Study A on page 176). Our efforts to introduce competition did not always result in privatization, however. Job placement services, for example, were retained and improved after it was determined that privatization would be a more costly alternative. Overall, introducing competition helped improve customer service, reduce cycle time, and reallocate resources needed in other high-priority areas.

Introducing competition into government and not-for-profit organizations requires careful strategy in order to be successful. *Using Competition for Performance Improvement* discusses techniques and tools for getting started. It is designed to provide valuable guidance for CPAs who are currently involved or wish to be involved in introducing competition. Practical outsourcing and divestiture examples are presented in such competition approaches as contracting, managed competition, vouchers, franchising, partnerships, volunteerism, service shedding, and asset sale or lease. Guidance is also included on how to select the most appropriate approach or strategy. Topics include—

- Identifying opportunities for introducing competition.
- Evaluating functions and activities for potential outsourcing or divestiture.
- Developing a competitive proposal.
- Planning the scope of a project.
- Addressing transition issues.

- Performing an objective analysis of the competitive proposal.
- Determining the most cost-effective methods of delivery.
- Selecting a service provider and monitoring performance.

Using Competition for Performance Improvement is intended to be a self-contained reference manual. Numerous tools, exhibits, spreadsheets, a PowerPoint Presentation diskette, case studies, and information sources are provided.

This book was first conceived in the late 1990s by a task force appointed by Tim Green, then chairman of the AICPA Government Accounting and Auditing Committee. The task force includes members with expertise in both the government and not-for-profit arenas. Tim charged us to generate AICPA vision-aligned ideas for expanding CPA services in the government sector. We quickly developed a number of ideas for which practice aids, courses, and other materials could be developed to assist CPAs in improving governmental operations. It was obvious to us that many of the proposed practice aids would be helpful to CPAs interested in improving the operation of not-for-profit organizations, as well as governments. Consequently, task force members were also recruited from the AICPA's Not-for-Profit Organizations Committee, and the scope of the project was expanded to include not-for-profit organizations.

The first subject area selected for development by the task force was using competition as a strategy for improving the operations of government and not-for-profit organizations. In *Using Competition for Performance Improvement*, Mike Crawford and task force members have combined their knowledge and insight to produce a comprehensive approach to address the needs of organizations in complex environments, as well as those that are more simplistic. The experience of the author and task force members provides CPAs with valuable guidance on this subject. We hope to develop a series of practice aids and materials to assist CPAs in addressing other areas for the future.

Finally, I wish to acknowledge the Arizona Governor's Office for Excellence (OEG). Our experience in introducing competition at DES reinforced the importance of following a systematic process to help ensure success. We benefited by using the approach developed by OEG. This book borrowed heavily from the concepts included in the OEG's publication titled *Competitive Government Handbook*. Likewise, I would expect the concepts and tools included in this book to help CPAs working within, or providing external services to, government and not-for-profit organizations.

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Chapter 1:

Introducing Competition: Considerations for Government and Not-for-Profit Organizations

New opportunities abound in providing quality professional services to government and not-for-profit organizations. In facing the challenges of the new millennium, government and not-for-profit organizations are under increasing pressure to accomplish the mission for which they were established more efficiently and effectively. More specifically, government and not-for-profit organizations are often expected to deliver services both efficiently and effectively as though they were in direct competition with private businesses. In addition, not-for-profit organizations must compete with other not-for-profit organizations, governments, and businesses for essential resources. For these reasons, entities are more often considering privatization and other opportunities to introduce competition into their functions and activities.

CPAs' skill set of financial acumen, technical knowledge, and business consulting competencies makes them uniquely qualified to assist in, advise about, or lead the process of introducing competition in the operations of government and not-for-profit organizations. CPAs' experience with project management, accounting/information system and process design, cost accounting analysis, and auditing and monitoring functions enhance the decision-making processes inherent in introducing competition and bring additional value-added benefits that can result in significant improvements to economy and efficiency.

The use of competition in the government and not-for-profit sector is ongoing. Consider these published results from recent efforts to use competition:

- The City of Indianapolis, Indiana, estimated that between the years 1995 and 1997, it saved approximately $4.2 million by introducing managed competition into its vehicle maintenance function.[1]
- The University of Western Ontario, London, Ontario, Canada, achieved a $1 million sales increase and 17 percent cost reduction over a three-year period through reengineering its food service function and introducing partnership relations with outside businesses.[2]

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1 U.S. General Accounting Office, *Privatization—Lessons Learned by State and Local Governments,* Appendix III (March 1997).

2 National Association of College and University Business Officers (NACUBO), "Higher Education Award Program (HEAP)," available at www.nacubo.org.

- The State of Massachusetts estimated that, for a two-year period of outsourcing its social services revenue billing and collection function, it increased revenue collections by $87 million, or 40 percent.[3]
- The National Council on Aging reduced the turn-around time of its monthly financial reporting from six weeks to seven days through outsourcing.[4]
- Through outsourcing its tax form processing activity, the State of New York estimates annual cost savings of $7.5 million.[5]
- In 1998, the City of Carrollton, Texas, realized a dramatic improvement in and upgrade to its information processing and communications systems through outsourcing its information technology function to outside technical experts. Employee and customer satisfaction was significantly increased.[6]
- By outsourcing the fulfillment of its magazines and products, the National Geographic Society reduced its service costs by more than $15 million annually.[7]
- The City of Phoenix, Arizona, estimated a cost savings or avoidance of over $30 million from 1979 through 1999 through the introduction of managed competition in its refuse collection and landfill operations.[8]
- Slippery Rock University, Slippery Rock, Pennsylvania, improved operations and student satisfaction by "getting out of the copier business." The university replaced 52 coin-operated copiers on campus with machines operated and maintained by an outside vendor that used debit card readers for easy student use.[9]

The opportunities for introducing competition into government and not-for-profit organizations include a wide range of functions and activities, such as administrative services, health and welfare, transportation, education, social services, utility services, cultural and recreational activities, and many others. (See chapter 2, "Identifying Opportunities for Introducing Competition," for specific functions and activities that represent potential competition candidates.)

JUST WHAT IS MEANT BY INTRODUCING COMPETITION?

Competition occurs when two or more parties independently attempt to secure the business of an entity by offering the most favorable terms. Competition in relation to government or not-for-profit organizations and for-profit businesses (referred to as the private sector) can be categorized in three general ways:

1. *Government or not-for-profit organizations versus private sector,* in which government and not-for-profit organizations compete with the private sector to perform functions or activities previously performed by the government or not-for-profit organization

[3] See footnote 1.
[4] National Council on the Aging, Inc.
[5] See footnote 1.
[6] Gary W. Jackson, "The Quantum Leap—The City of Carrollton Pioneers Information Technology Outsourcing," *Texas Town & City* (August 1999).
[7] The National Geographic Society.
[8] Bob Wingenroth, "City of Phoenix Public/Private Competitive Proposal Process Report," a 2000 report by the City Auditor's Office.
[9] See footnote 2.

2. *Government or not-for-profit organizations versus other government or not-for-profit organizations,* in which government and not-for-profit organizations compete among themselves to perform their functions or activities
3. *Private sector versus private sector,* in which private-sector organizations compete among themselves to perform government and not-for-profit organization functions or activities

What is important to note is the end result of introducing competition is *not always privatization.* The performance of the service by an outside provider may not always be the "best fit" for a function or activity in which competition may be introduced. For many reasons, government and not-for-profit organizations must continue to provide certain services. In some instances, legal or regulatory requirements may require the service to be performed in-house. In others, privatization may not be viable for other reasons.

For example, the function or activity may not be available in the private sector, the private sector may not be interested in providing the service, or the entity may find it can provide the service at less cost. In these situations, the process of introducing competition can still result in improvement to the quality of service or reduction in costs from the entity retaining and modifying the service delivery.

Whether for a CPA performing consulting services or a CPA working for a government or not-for-profit organization, this ever-increasing focus on introducing competition provides significant opportunities to deliver professional services in an area that is actively growing.

Alternative Actions Resulting From Introducing Competition

As previously discussed, the end result of introducing competition is not always privatization. Alternative actions resulting from introducing competition can generally be classified into three categories: privatization, retention, and reengineering. These categories represent broad types of action that can result from introducing competition. There are specific competition strategies or approaches to be considered, including contracting out, managed competition, vouchers, partnerships, franchises, volunteerism, service shedding and asset sale or lease (see chapter 2).

Privatization

The term *privatization* has generally been defined as any process aimed at shifting activities, functions, and responsibilities, in whole or in part, from a government to a private sector business. For the purposes of this publication, privatization includes any process aimed at shifting activities, functions, and in some cases, responsibilities from a government or not-for-profit organization to another government or not-for-profit organization or to the private sector. Privatization actions can generally be classified as either outsourcing or divestiture.

1. *Outsourcing* is a privatization action in which the government or not-for-profit organization remains fully responsible for providing the targeted functions or activities and maintains control over management decisions, while another entity operates the function or performs the services. In other words, the organization can outsource the tasks but not the responsibilities. For example, while a government might outsource its solid waste collection service or a not-for-profit organization might outsource its accounting function, if the service is not satisfactory or performance declines, the government or the not-for-profit organization—not the outside entity performing the service—will be accountable to the service recipients.

2. *Divestiture* is a privatization action in which decisions are made to eliminate a service or function entirely or in part. Divestiture occurs when a government or not-for-profit organization reduces the level of service provided or stops providing a service altogether. In some cases, private-sector businesses step in to provide the service if there is sufficient market demand. In other cases, the service could shift in terms of performance and responsibility between government and not-for-profit organizations. Divestiture is considered different from outsourcing in that the government or not-for-profit organization no longer retains responsibility for the previously performed function or activity's service. It is also possible that the eliminated service will no longer be provided by any entity. For example, a government owning and operating a hotel could decide to close the hotel due to the lack of market demand for rooms and no interested buyers or operators.

Retention

A government or not-for-profit organization may decide to retain the targeted function and continue to perform the services with little or no modification. In such a case, the process of introducing competition can still serve as a motivation for the entity and its management and employees to be more efficient and effective. In addition, any cost-of-service information gathered and analyzed in the process of introducing competition can be useful for other purposes, such as performance measurement and rate setting.

Reengineering

A final alternative is for the government or not-for-profit organization to retain the targeted function but modify or reengineer its service delivery approach. The objective of this alternative would be for the government or not-for-profit organization to make changes identified through the competition process to become significantly more efficient, effective, or both.

Opportunities for CPAs in the Competition Process

All levels, types, and sizes of government and not-for-profit organizations can benefit from CPA involvement in the competition process. The levels of government include the federal government, state and county governments, municipalities, school districts, and other special-purpose governments. All types and sizes of not-for-profit organizations are also potential candidates for these services.

The opportunities for CPAs to provide services range from assisting in the identification of potential competition candidates to project management, assistance and consultation, and even being the outsource provider. CPAs' skills and competencies, including project management skills, system or process design skills, cost accounting competencies, and financial and compliance audit experience, are specifically tailored to assist entities in the competition process. In addition, through the normal accounting and audit services typically provided on an annual basis, CPAs have an extensive and in-depth working knowledge of the activities and functions of government and not-for-profit organizations. The following is a listing of example services the CPA can provide government and not-for-profit organizations considering the introduction of competition:

- Competition process design
  —Designing or developing the processes or procedures to be used in the competition project
  —Assisting in the implementation of the system or process designed
  —Providing or assisting in the design of useful forms and schedules
- Identification of potential functions or activities to be analyzed
  —Defining the applicable functions and activities
  —Categorizing the functions and activities by organizational priority (that is, most to least critical to organization's goals)
  —Identifying the target functions or activities that are competition candidates
- Qualitative analyses of target function or activity
  —Performing market assessments (availability of service providers)
  —Conducting capacity analyses
  —Providing benchmarking services for performance monitoring
  —Completing a competitive profile of the target function or activity
- Project management and assistance
  —Participating as a member of, or adviser to, the competition task team
  —Assisting in the selection of the best and most appropriate competition strategy or method
  —Developing a performance measurement plan, including developing appropriate performance measures
  —Assisting in the development of service delivery and personnel plans
  —Preparing the request for proposal (RFP) for competitive bids
  —Providing advice to the evaluation committee on the evaluation of the responses to the RFP and on the selection of a provider
  —Assisting in the development and negotiation of a service contract with the selected provider
- Cost analysis and comparison
  —Performing activity-based costing studies
  —Performing the cost analysis and comparing in-house and outside costs
- Performance monitoring
  —Performing contract or project monitoring, including both financial and performance monitoring
- Outsourcing opportunities for CPAs
  —Performing internal audit activities
  —Performing financial administration activities, including payroll, purchasing, billing, and general accounting services
  —Preparing internal and external financial reports

When performing any of these outsourced activities for an audit or other attestation client, CPAs should ensure they have considered the independence requirements of applicable professional standards.

The CPA is uniquely qualified to be a leader in the process of assisting and advising government and not-for-profit organizations interested in introducing competition, and the opportunities for providing services are extensive.

How to Sell the Competition Philosophy to Clients or Employers

Both large and small government and not-for-profit organizations are interested in becoming more effective and efficient in delivering their services. Since the introduction of competition can achieve these objectives, it should be relatively easy for CPAs to initiate interest in the philosophy. Whether it is outsourcing the internal audit function of a large not-for-profit organization or privatizing the solid waste activity of a small town, the goal is to provide quality service in a cost-effective manner.

High-level organizational leaders are needed to develop and communicate a competition policy and garner public, business, and political support. Whether the leader is a state governor, state department head, county commissioner, municipal mayor or manager, not-for-profit board chairman, or executive director, such high-level support and leadership appears to be an essential element in successful efforts to introduce competition. Therefore, when attempting to sell this concept or service to clients or employers, CPAs should identify such a leadership candidate and obtain the candidate's support. Then specific opportunities for the introduction of competition can be identified (as discussed in chapter 2), and specific proposals can be presented to the organization. (Also, see chapter 8 for an electronic slide presentation, including presentation tips, for use by the CPA in marketing these services.)

Real-life examples of previous successful efforts to compete within the government or not-for-profit organization or examples from similar entities provide strong selling points and should be used when available in convincing decision makers. (See exhibit 1.1, "Examples of Successful Privatization Projects Included in the U.S. General Accounting Office Study," for documented examples of successful competition efforts.)

Understanding Government and Not-for-Profit Organizations

While government and not-for-profit organizations are different in certain aspects, such as applicable accounting principles, laws and regulations, and primary funding sources, both these types of organization are quite similar when considering the introduction of competition. Such similarities include emphasis on public service, tax-exempt status, and their constituents' expectations to receive services both efficiently and effectively at the lowest possible cost. Due to these similarities, this publication presents information uniformly and does not differentiate between government or not-for-profit organization status, unless otherwise specified. CPAs considering providing competition introduction services need to understand the goals, constraints, and impediments involving government and not-for-profit organizations.

The Goals of Governments That Consider Introducing Competition

The primary goal for a government considering competition is to establish open and fair competition in providing goods and services, thereby creating an environment for cost-effective and efficient delivery. Governments are facing increasingly scarce public funding, federal government devolution, and increasing demands for services. For state and local governments that adopt generally accepted accounting principles (GAAP), the financial reporting requirements in Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local*

Governments, which highlight the net expense or revenue for each government function or activity, have generated increased interest in the public and others in the cost of services being provided. Also, the recent trend in all levels of government of developing and using performance measures will likely provide many organizations with an indication of areas that need to be operated more efficiently and effectively. As a result of these factors, elected officials and the public are increasingly demanding that governments allow the private sector and not-for-profit organizations, or in some cases other governments, to compete for the delivery of certain services and functions. A competitive government program can be a tool that helps enable governments to better meet the needs of their constituents and customers by lowering costs, improving service, or both.

The Goals of Not-for-Profit Organizations That Consider Introducing Competition

Similarly, not-for-profit organizations are facing stiff competition for charitable giving dollars, and they need to demonstrate that program outcomes are produced in the most cost-effective manner. The giving public has expressed increasing interest in and sophistication about what not-for-profit organizations are doing with their money. This pressure to limit overhead and fund-raising costs has been heightened by not-for-profit "watchdog" organizations and various state attorneys general who have expressed concern over abuses by a small number of organizations.

Politics, Constraints, Accountabilities, and Other Issues

A driving force behind the decision to introduce competition is the need for government and not-for-profit organizations' accountability to their constituents, taxpayers, customers, donors, and grantors. However, certain impediments to introducing competition may exist due to the nature of these types of entities. While most of these impediments affect governments more than not-for-profit organizations, certain constraints can also affect the not-for-profit organizations.

The democratic form of government sometimes has unintentional inefficiencies as a result of the concept of separation of powers and the perceived need to place tight limits on government powers to guard against corruption and abuse. For example, rule making by government agencies often requires a slow, deliberate process of public input and involvement before action can be taken. While this is important for good public accountability, it is somewhat inefficient. In other words, public administrators are often unable to operate governments in a totally business-like fashion.

Also, many governments operate under the provisions of laws and regulations that could impair their ability to introduce competition. In addition, not-for-profit organizations may be restricted by grant award contractual requirements that could affect their ability to introduce competition. Also, employee labor contracts may contain employment provisions that could hinder competition efforts. Laws and regulations, including grant award agreements, may also stipulate the specific manner in which competitive bids must be obtained.

In addition, campaign or fund-raising promises, lobbying efforts, and other political forces may have a significant impact on the process of introducing competition. In some cases, legislative or policy changes may be required to encourage and facilitate the introduction of competition. Such legislative or policy changes can also serve as proof to all parties involved that the entity is serious about its efforts to introduce competition.

BENEFITS OF INTRODUCING COMPETITION

Competition is a management tool that enables governments and not-for-profit organizations to better meet the needs of their constituents, customers, or clients by lowering costs, improving service, and ultimately refocusing these entities on the core services that they should or must provide. Implementing a competitive environment in a fair and consistent manner will lead to—

- *Cost savings.* Competition in the marketplace results in continuous focus on cost savings.
- *Improved service quality.* Well-designed contracts, specific performance standards, and comprehensive monitoring result in increased quality of service.
- *Increased efficiency.* Competition drives parties to become innovative to continue to deliver services in new and improved ways.
- *Increased flexibility.* The consideration of alternative methods of service delivery provides officials with greater flexibility in their efforts to meet users' needs.

The focus of the competition process is not necessarily privatization of services; rather, the emphasis is on achieving the benefits noted here within an overall goal to improve performance.

INDICATIONS THAT COMPETITION MAY BE NEEDED

How is a needed change in the method of service delivery identified? If something has always worked in the past, why change? As public and not-for-profit administrators continue to struggle to both meet the needs and expectations of their constituents or resource providers efficiently and effectively, they must become aware of key factors that could indicate the time for change is near or here. These factors may be economic or political, and quantitative or qualitative.

Financial Statement Warning Signs

Whether measuring the fund balances of government funds, the net assets of not-for-profit organizations, or the net income of government business-type activities, administrators should be concerned about a trend of continuous decline in these measures. While a single year of deteriorating fund balance or net assets or net loss can be tolerated and can be often explained with unusual or nonrecurring financial activity, a long-term trend of decline is a clear indication that the entity is experiencing an extended period in which costs for certain activities and programs are more than revenues.

Where can such trend information on net assets and net costs for activities be found? The financial statement format and presentation of both government entities and not-for-profit organizations facilitate the comparison of costs to revenues. State and local government entities that follow GASB Statement No. 34 are capable of tracking changes in net assets, and costs versus revenues by function or activity within the government-wide statement of activities.

> **Example.** Exhibit 1.2 is an example government-wide statement of activities for a local government. A close review of the net expenses (revenues) column in the exhibit indicates that for the sanitation business-type activity the cost of service exceeds the service-generated revenue by $362,350. This represents an activity that may be a candidate for considering the introduction of competition from the efficiency perspective. While the exhibit indicates a number of functions or programs reporting negative net revenue, such as general government, public safety, transportation, cultural, and community/economic development, this likely results from the fact that these traditional government services are basically funded with tax dollars and are not similar to services normally provided by the private sector and funded by user charges. As a result, these services nearly always reflect negative net revenue and, therefore, they do not necessarily indicate a need to consider introducing competition. However, competition may still be introduced in these areas in an effort to improve performance. Business-type activities, such as water, wastewater, and sanitation services, that report negative net revenues may indicate a need to consider the introduction of competition from the efficiency perspective.

Not-for-profit organizations that follow Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 117, *Financial Statements of Not-for-Profit Organizations*, are capable of tracking revenues versus expenses by function within a statement of revenues and expenses by function.

> **Example.** Exhibit 1.3 is an example statement of revenues and expenses by function for a not-for-profit organization. A close review of the excess (deficit) of revenues over expenses in this exhibit indicates that, for all functions combined, the association is incurring a deficit of revenues over expenses of $60,710,000. The deficits by function range from a low of $1,000,000 in legislative affairs to a high of $36,650,000 in publications. While deficits would be expected for such functions as administration and legislative affairs since they are not revenue-generating functions, the deficits in the other functions—membership, publications, communications, and education—may be financial warning indicators and may indicate a need to consider the introduction of competition from the efficiency perspective.

These examples focus on external financial statement warning signs of a government entity's activities where the statements are presented in accordance with GASB Statement No. 34, and a not-for profit organization's activities where the statements are presented in accordance with FASB Statement No. 117. External financial statements of government and not-for-profit organizations not reporting in accordance with GAAP likely do not produce the cost-of-service information by activity necessary for identifying warning signs. However, such activity-based cost information may be available from internal financial reports and accounting records.

Pressure From Governing Boards, Constituents, Donors, Grantors, and Others

As inflation occurs and costs of services continue to rise, administrators struggle with the ability to raise recurring revenues to fund these additional costs. With the continued revenue-raising caps placed on government by taxpayers and increased competition among not-for-profit organizations for donations and grants, there is an increasing need to consider competition as a viable alternative.

Example. A tax reform initiative was introduced in the State of Wisconsin titled the Fair Tax Plan, which called for the following reforms that, if passed, would place enormous pressure on the state to reduce expenses: [10]

- Stop taxes on property—slash Wisconsin tax 85 percent
- Fund equal education opportunity with fairer taxes
- Cut Wisconsin income and sales tax rates 20 percent to 40 percent
- Make taxes fair—end special-interest exemptions and influence
- Make government efficient
- Replace incumbents who fail to produce this reform

Introducing competition is one alternative to addressing the pressures of such an initiative. In addition, primarily within governments, there are often political issues that result in pressure from governing or oversight bodies to consider competition. Such pressures result from campaign promises, political lobbies, or personal preferences of elected officials.

Indications in Performance Measures

Recent trends in large government and not-for-profit organizations indicate that the development and tracking of performance measures is increasingly becoming a standard management process. Many government and not-for-profit organizations are using input, output, and outcome measures both to budget certain functions or activities and to determine the attainment level of goals. As these performance measures change, especially when increasing inputs result in decreasing outputs or outcomes, pressures to compete in the provision of services are likely to increase.

Example. In years before 1984, the City of Phoenix had outsourced its emergency transportation services to outside private firms. In 1984, the city decided to have its fire department compete with outside private firms for the provision of these emergency transportation services. During the time the services were performed by the outside firms, the average responses made within ten minutes of the call had decreased to approximately 47 percent. The fire department subsequently was awarded this service through managed competition, and since that time, they have increased the percentage of responses within ten minutes to over 90 percent.[11]

(See chapter 3, "Planning to Introduce Competition," for a more detailed look at the use of performance measures by government and not-for-profit organizations.)

Previous Successful Competition Experiences

Factors that indicate an entity should consider competition do not always have to be negative factors or pressures. Previous successful experiences resulting from the use of competition can be strong factors in further efforts to compete. Success breeds more attempts at success.

[10] Fair Tax Plan for States, Wisconsin Tax, Education and Government Reform (www.fairtaxes.com).
[11] See footnote 8.

> **Example.** Successful competitive contracting efforts by the City of Portland, Oregon, in the area of water services led to the development of a formal study and report in May 1995 by the Portland City Auditor's Office titled *Competitive Contracting: Opportunities to Improve Service Delivery and Save Money.* This report came to the following conclusion: "Competitive contracting of public services appears to offer real benefits to those governments that implement it well." The report further recommended a number of suggested guidelines to help the City of Portland benefit from competition.[12]

Competition successes could result in substantial cost savings, revenue enhancement, improved service delivery, quality of life enhancements, and improved productivity.

LESSONS LEARNED FROM INTRODUCING COMPETITION

There is much to be learned from those who have experience—including both successful and unsuccessful efforts—in introducing competition. In March 1997, the U.S. General Accounting Office (GAO) released a report to the U.S. House of Representatives' Republican Task Force on Privatization titled *Privatization—Lessons Learned by State and Local Governments.* The GAO study's objective was to ascertain the lessons learned by, and the related experiences of, state and local governments in privatizing government services. Although the study addressed only certain state and local governments, the important lessons learned and conclusions reached are also applicable to other types of government and not-for-profit organizations. The GAO visited six large governments that had developed and used tailored approaches and interviewed a panel of privatization experts. (See exhibit 1.1 for example competition projects and their reported results from this GAO report.) From their work, the GAO identified six lessons learned that were generally common to all six governments in implementing privatization initiatives. Positive or negative though these may be, they are important lessons and CPAs should consider them when assisting a government or not-for-profit organization that is introducing competition.

1. Privatization can best be introduced and sustained when organizational leadership champions it.
2. Leaders need to establish an organizational and analytical structure to ensure effective implementation.
3. Governments may need to enact legislative changes, reduce government resources, or both, to encourage greater use of privatization.
4. Reliable cost data on activities are needed to support informed privatization decisions and to assess overall performance.
5. Entities need strategies to manage workforce transition.
6. More sophisticated monitoring and oversight are needed to protect the entity's financial interest and its customers' service interests when its role in the delivery of services is reduced through privatization.

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[12] City of Portland, Office of City Auditor, *Competitive Contracting: Opportunities to Improve Service Delivery and Save Money*, Report No. 179 (May 1995).

A copy of this report is available free of charge from the GAO by mail, phone, or via the Internet:

U.S. General Accounting Office
P.O. Box 6015
Gaithersburg, MD 20884-6015
Phone: (202) 512-6000; fax: (301) 258-4066
GAO Web site: www.gao.gov
E-mail: info@www.gao.gov.

While important lessons are learned from successful efforts to introduce competition, as is the case with most new initiatives, many lessons are also learned from previous unsuccessful attempts or ventures. Most of the unsuccessful efforts or ventures are the result of the failure to follow a structured and comprehensive approach to making the competition decision. Knee-jerk reactions to perceived problems or pressures often result in inappropriate decisions or actions. Some examples of difficulties encountered in competition efforts include the following:

Situation. A local government encountered early opposition to its attempts to introduce competition from employee unions.

Lesson. Formally involve the unions in the competition process. Managed competition (see chapter 2) was considered as an alternative in order to allow the local government's department to compete for providing the service. The employees were allowed to compete.

Situation. A public college outsourced its bookstore activities to a local private sector business that was the only other local competitor. Once the local business had the contract, it raised its prices to students and provided poor service. Students protested loudly to the college.

Lesson. Outsourcing to the only remaining competitor resulted in a monopolistic environment that increased the risk of failure to achieve competition objectives. This outsourcing action should have been avoided.

Situation. A not-for-profit organization outsourced its finance and internal audit activities to achieve cost savings. However, no cost accounting information was available to compare in-house costs to competitive outside bids. As a result, the ultimate cost of the selected provider well exceeded the in-house costs previously incurred.

Lesson. Cost accounting information, including direct, indirect, and one-time costs, is a necessity for proper consideration in making competition decisions.

Situation. A not-for-profit organization outsourced its senior citizen transportation program. The program was funded through local contributions and a federal award. Following a program audit, instances of noncompliance were noted in the operation of the program, and program goals were not being achieved. The federal agency threatened to discontinue future funding.

Lesson. The entity can outsource certain tasks, but it cannot outsource its responsibilities. Program monitoring by the not-for-profit organization should have been an essential element of the outsourcing project.

OTHER TIPS ON INTRODUCING COMPETITION

A fundamental principle applicable to introducing competition into government and not-for-profit organizations is the principle of *competitive neutrality*. The Reason Foundation's Public Policy Institute (a national research and education organization dealing with public policy issues) describes competitive neutrality as "all policies and legal arrangements that ensure that all organizations and individuals—public, private, and nonprofit—are treated in an equal manner in the bidding process between public and private bidders." Elements of competitive neutrality include the following:

- In-house costs must be calculated accurately, completely, and fairly.
- When possible, performance bonds should not be requested from private vendors if not made applicable to government and not-for-profit organization providers.
- Government and not-for-profit organization providers should not be subsidized when being compared to private providers.
- A formal complaint process for private providers that claim an unfair bidding process should be created.
- Employment, wage, and benefit mandates placed on competitors should be minimized.

If these elements are present and implemented, a level playing field between the government and not-for-profit organizations and the private sector can be created, increasing the chances for a successful environment.

An article titled "Smart Outsourcing Strategies" suggests the following when considering outsourcing.[13]

- Never outsource the core business or activities—even if it can save money in the short run. Lose control of the core business and the entity is guaranteed to lose its competitive edge.
- Do not let cost savings alone be the deciding factor in making an outsourcing decision.
- Recognize that even the best legal contract cannot save the entity from conflict with an outsource partner. The best defense is selecting a partner or contractor that reflects the entity's business style and understands the reason for outsourcing.
- Resist outsourcing any part of customer or constituent relations activities. Those areas are too sensitive to trust to someone outside the entity.
- Establish clear-cut performance standards for an outsource provider, and set up a process to monitor them regularly.

OVERVIEW OF HOW THE COMPETITION PROCESS WORKS

Competition programs or processes are designed to achieve the ultimate objective of providing the most cost-effective and efficient service, whether provided by the government or not-for-profit organization or a for-profit provider (see table 1.1 for an overview of the competition process, including the major tasks involved). The competition process, as presented in this publication, is designed to help CPAs assist their clients or employers with the following:

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[13] "Smart Outsourcing Strategies," *Journal of Accountancy* (February 2001), p. 120.

- Identifying specific opportunities for competition
- Preparing for competition and possible transition of service delivery
- Conducting a cost analysis, including a comparison between relevant in-house costs and outside provider costs
- Making the decision on provider selection and implementing transition and monitoring plans

TABLE 1.1 OVERVIEW OF THE COMPETITION PROCESS

Identifying Competition Opportunities	Planning to Introduce Competition	Performing the Cost Analysis	Selecting a Provider
Identify target functions or activities. Form a competition task team. Conduct a qualitative analysis of target function or activity. Select a competition alternative action, such as privatization, retention, or reengineering. Select a competition strategy, such as contracting out or managed competition.	Determine scope of project. Develop a performance monitoring plan to monitor provider. Develop a transition logistics plan, in case the target function or service is transferred to a new provider. Develop a personnel plan to address any personnel transition issues. Address stakeholders' concerns, such as elected officials and board members, employees, customers, taxpayers, constituents, clients, and donors. Determine whether to proceed.	Determine approach to identifying and accumulating costs of service. Identify and accumulate relevant in-house costs. Prepare and issue a request for proposal (RFP) for interested outside providers. Evaluate responses to the RFP from outside providers. Identify and accumulate outside costs of the most advantageous outside provider. Compare in-house relevant costs to outside costs, and recommend either in-house service delivery or outside delivery from the cost savings perspective.	Appoint an evaluation committee. Select future provider. Develop a written contract with the selected provider. Implement the transition logistics plan provisions. Implement the personnel plan provisions. Implement the performance monitoring plan provisions and conduct monitoring as scheduled.

Note: All of these steps in the competition process are covered in chapters 2 through 5.

CONCLUSION

While the concept of introducing competition into government and not-for-profit organizations is not a new one, it is receiving renewed attention in these entities' efforts to become more efficient and effective. As a result, CPAs and CPA firms have significant opportunities to assist these entities in their efforts to introduce competition. For competition projects to be successful, a comprehensive and structured evaluation process is essential. CPAs' skills and competencies are a direct match for such a comprehensive and structured approach. CPAs, whether involved as leaders in the entire competition process or serving as advisers in various phases of the process, are in a unique position to add value to the process of introducing competition. This publication will guide the CPA through such a process to assist in providing a high-quality service. (See the appendixes to this publication for a glossary of terms and answers to frequently asked questions regarding the introduction of competition.)

Exhibit 1.1 Examples of Successful Privatization Projects Included in the U.S. General Accounting Office Study

Government/Project	Primary Reason	Form of Privatization	Reported Results (a)
City of Indianapolis, IN / Maintenance of city vehicles	Cost savings	Outsourcing	Estimated $4.2 million in cost savings between 1995 and 1997
			Fewer labor grievances in first year
			Cost of workers' compensation claims decreased by two-thirds
City of Indianapolis / Delinquent tax collections	Increased collections	Outsourcing	Estimated $6.8 million in increased collections in the first year
City of Indianapolis/ Wastewater treatment	Cost savings	Outsourcing	Estimated $65 million savings between 1994 and 1996
			Combined sewer overflows reduced by 50%
State of Massachusetts / Milledgeville War Veterans Home	Cost savings	Outsourcing	Estimated cost savings of 57% for 5 years
			Staff are more responsive to family concerns and inquiries
			Quality of life enhancements include cleaner home, better food, and cable TV
State of Massachusetts / Social Services Revenue Management	Increased collections	Outsourcing	Estimated increase of $87 million during the first 2 years of contract
			Increased revenue used to boost the agency's child welfare services
State of Massachusetts / Prison Health Care	Cost savings and improved care	Outsourcing	Estimate annual cost savings of $8 million per year over 5-year contract term
			Number of prisons meeting accredited health standards in the state went from 0 of 20 to 10 of 20.

Exhibit 1.1 *(continued)*

Government/Project	Primary Reason	Form of Privatization	Reported Results (a)
State of New York / Workers Comp Accident Fund	No longer considered a government function	Divestiture	$261 million gain for the state from sale of fund
			Reduction in private company's rates by an average of 9.2% in first year
			Potential for political interference in ratemaking process removed
			New products, such as group dividends, introduced by private company
State of New York / Tax Form Processing	Cost savings and improved efficiency	Outsourcing	Estimated annual savings of $7.5 million
State of New York / Vista Hotel	No longer considered a government function	Divestiture	Hotel sold by the state for $141.5 million

(a) All results are those reported by the government officials. GAO performed no audit to verify.

Source: Adapted from "Lessons Learned by State and Local Governments," an *Overview of Recent Privatization Efforts in the Six Governments,* a GAO Report to the Chairman, House Republican Task Force on Privatization (March 1997). GAO/GGD-97-48.

Exhibit 1.2 **Example Statement of Activities for a Local Government**

Example City
Statement of Activities
for the Fiscal Year Ended June 30, 20XX

Functions and Programs	Expenses	Program Revenues: Charges for Services	Program Revenues: Operating Grants and Contributions	Program Revenues: Capital Grants and Contributions	Net (Expenses) Revenue and Changes in Net Assets: Governmental Activities	Net (Expenses) Revenue and Changes in Net Assets: Business-type Activities	Net (Expenses) Revenue and Changes in Net Assets: Total
Governmental activities:							
General government	$ 441,915	$ 15,444	$ -	$ -	$ ($426,471)	$	$ ($426,471)
Public safety and judiciary	2,156,558	367,706	77,647	-	(1,711,205)		(1,711,205)
Transportation	803,116	4,750	-	437,243	(361,123)		(361,123)
Cultural, parks and recreation	1,112,168	313,497	5,138	25,456	(768,077)		(768,077)
Community/economic development	1,218,290	-	74,323	8,511	(1,135,456)		(1,135,456)
Total governmental activities	5,732,047	701,397	157,108	471,210	(4,402,332)		(4,402,332)
Business-type activities:							
Gas	2,411,385	2,691,883	-	36,608		$317,106	317,106
Garage	48,370	-	-	-		(48,370)	(48,370)
Water	1,104,696	1,324,923	-	63,678		283,905	283,905
Sewer	1,125,812	1,695,601	-	116,169		685,958	685,958
Sanitation	805,778	443,428	-	-		(362,350)	(362,350)
Farm	109,224	129,344	-	-		20,120	20,120
Total business-type activities	5,605,265	6,285,179	-	216,455		896,369	896,369
Total	$ 11,337,312	$ 6,986,576	$ 157,108	$ 687,665	(4,402,332)	896,369	(3,505,963)
General revenues:							
Taxes:							
Sales and use taxes					3,329,481	-	3,329,481
Property taxes, levied for debt service					3,986	-	3,986
Franchise and public service taxes					163,289	-	163,289
E-911 taxes					71,454	-	71,454
Hotel/motel taxes					83,459	-	83,459
Airport fuel taxes					6,254	-	6,254
Intergovernmental					148,738	-	148,738
Investment income					82,728	163,676	246,404
Miscellaneous					147,629	45,400	193,029
Transfers					518,991	(518,991)	-
Total general revenues and transfers					4,556,009	(309,915)	4,246,094
Change in net assets					153,677	586,454	740,131
Net assets - beginning					9,325,102	15,090,851	24,415,953
Net assets - ending					$ 9,478,779	$ 15,677,305	$ 25,156,084

Exhibit 1.3 Example Statement of Revenues and Expenses for a Not-for-Profit Organization

Association XYZ
Statement of Revenues and Expenses
Year Ended December 31, 20XX
(000s)

REVENUES:	Membership Programs	Publications Division	Office of Communications	Legislative/Govt Affairs	Education Programs	Administrative Programs	Association Total
Publication sales	$1,200	$46,500		$200	$3,500		$51,400
Advertising		16,400					$16,400
Dues	7,500		3,300				$10,800
Registration fees	4,500				5,500		$10,000
Total revenues	$13,200	$62,900	$3,300	$200	$9,000	$0	$88,600
EXPENSES:							
Salaries and benefits	$8,650	$44,550	$5,000	$350	$6,500	$400	$65,450
Depreciation	10,100	15,000	650	500	7,500	650	$34,400
Professional services	1,000	6,000	800	350	650	2,500	$11,300
Editorial/distribution	960	25,500			2,000		$28,460
Travel	100	8,500			250	100	$8,950
Grants and awards					750		$750
Total expenses	$20,810	$99,550	$6,450	$1,200	$17,650	$3,650	$149,310
Excess (deficit) of revenues over expenses	($7,610)	($36,650)	($3,150)	($1,000)	($8,650)	($3,650)	($60,710)

Chapter 2:

Identifying Opportunities for Introducing Competition

Successful introduction of competition into government and not-for-profit organizations begins with the appropriate consideration of certain attributes inherent to the function or activity being targeted (the target function or activity). A target function could be the internal audit function of an entity, whereas a target activity could be the payroll processing activity of the administration function. One Internet resource (www.GovSalesNet.com, which targets government contracting opportunities) estimates that federal, state, and local government contracting totals $400 billion annually.

Factors for Successful Introduction of Competition

In identifying target functions or activities that are candidates for the introduction of competition, the CPA or CPA firm should evaluate the likelihood of achieving the government or not-for-profit organization's goals through a successful process.

The following factors or attributes are positive indicators of potential success:

- *A strong marketplace.* A number of potential suppliers should already exist in the market for the targeted function or activity. Without a competitive marketplace, the creation of monopolies is inevitable and planned goals may not be achieved.
- *The potential for improved quality.* The introduction of competition should increase the quality of service to the consumer, regardless of who ultimately performs the targeted function or activity. Projected quality should meet or exceed current service levels.
- *The assurance of continued control.* Introducing competition into a targeted function or activity does not mean the government or not-for-profit organization abdicates its responsibility to its constituents or customers. An appropriate level of monitoring or oversight over performance must be achieved, even when privatization is considered (unless privatization involves divestiture of the service).
- *The low risk of unfavorable exposure.* The introduction of competition should be attempted when the risk is low that using outside contractors would expose the government or not-for-profit organization to additional hazards, including legal or financial exposure, service disruption, corruption, and other risk factors.
- *Limited legal or political barriers.* Competition is most successful when it is not limited or hindered by laws or regulations or negatively affected by political forces.
- *Minimal employee impact.* Competition efforts are improved in situations where the net impact on affected employees is positive and the action is compatible with collective bargaining agreements.

- *Available resources.* Sufficient resources should be available to the potential competitors to ensure they possess or have access to the needed expertise, facilities, or equipment and time to provide the target function or activity service.

TARGET FUNCTIONS OR ACTIVITIES

In identifying competition opportunities, the CPA or CPA firm should apply the aforementioned criteria to specific services within the overall operations of the government or not-for-profit organization; these are called target functions or activities.

> **Example.** A not-for-profit museum operates a number of functions, including exhibit acquisition and maintenance, tour services, facility maintenance, gift shop operations, accounting and finance, and administration. If the entire accounting and finance operations were considered for the introduction of competition, they would be referred to as a target *function.*
>
> **Example.** The museum considers only the payroll processing activity within the accounting and finance function. The competition opportunity would be identified as a target *activity.*

Target functions or activities generally have one or more of the following attributes:

- The function or activity is not the core service of the government or not-for-profit organization.
- Sufficient outside provider interest is present.
- Customer, constituent, taxpayer, or client dissatisfaction has been expressed.
- A history exists of successful competition efforts by other similar entities.
- Cost problems are present.

Opportunities exist not only in services provided to external users (for example, solid waste collection and disposal), but also in services provided internally (for example, accounting and finance activities).

When considering whether a target function or activity is generally a sound competition candidate, the following general question should be considered:

> Is the target function or activity a core service of the organization or the primary reason why the government or not-for-profit organization exists?

If the answer is no, the target function or activity should generally be considered a potential competition candidate. If the answer is yes, this fact should be sufficiently mitigated by the presence of some of the other target function or activity attributes before further consideration of the target function or activity as a potential competition candidate. These other attributes include sufficient outside provider interest, service dissatisfaction, previous successful competition efforts by others, and concerns over cost.

Specific Candidates for Introducing Competition

The specific functions or activities that are candidates for competition are numerous. Although the most common functions and activities targeted in government and not-for-profit organizations are those that are similar to services provided by commercial or private-sector businesses, the list of potential target functions and activities is nearly endless (see table 2.1).

TABLE 2.1 OPPORTUNITIES FOR INTRODUCING COMPETITION

Function	Specific Activities
Administration	Cash and investment management Accounting and finance Internal auditing Information technology services Printing Payroll processing Purchasing and procurement Contract management Travel services Personnel services Benefits administration Legal services Pension administration Executive search Employee testing Engineering and architectural services Fleet and facility maintenance Custodial services Grants administration Document imaging and management Telecommunications Security Warehouse operations
Law enforcement and corrections	Housing, feeding, and training of inmates Medical services; Pharmacy; Religious services; laundry Prison or jail operations Work release and other inmate programs Investigative, security, and patrol services
Education	Bookstore Food services Student housing, transportation, and counseling Special education programs; library management Test scoring
Health and welfare	Drug and alcohol treatment; other counseling programs Hospital, clinic, and laboratory operations Research and development programs Environmental health programs Medicaid processing; insurance claims processing Mental heath programs and services Nursing home operations and services Sanitation (solid waste removal and recycling) Emergency services and ambulance

(continued)

TABLE 2.1 *(continued)*

Social services	Family planning and assistance services Youth and elder care programs and services Day care and other child care services Emergency shelters, education, and training Adoption and foster care services Client transportation, housing, and feeding Testing and screening services Physical, psychological, and occupational therapy Medical services
Transportation	Airport operations and concessions Architectural and engineering services Road, street, highway, and bridge construction and repair Grounds and road maintenance; railroad maintenance Public transit; snow removal; toll services Inspections and fleet maintenance
Culture and recreation	Sports program operations and officiating Grounds maintenance Tourism and convention services Theater and civic center management and bookings Library, museum operations
Customer services and member relations	Catalog services Licensing operations Gift shop operations Subscription services
Donor relations	Database management Mass-mailing services

Emerging Opportunities for Introducing Competition

Even though certain activities, such as solid waste collection and disposal, custodial and other maintenance services, food services, and engineering services, have been traditional candidates for the use of competition, recent trends indicate a significant widening of the opportunities being considered. For example, with the dynamic environment surrounding information technology, many government and not-for-profit organizations are considering the feasibility of outsourcing the operation and maintenance of their computer hardware and software systems. In addition, accounting, finance, and internal audit activities are increasingly being considered as candidates for the introduction of competition.

Recent reports on government and not-for-profit organization competition efforts indicate an environment of expanding opportunities. A few examples of these emerging opportunities follow.

> **Example:** According to a report included in the Web site of the National Association of College and University Business Officers (www.nacubo.org), in January 2001, the City Colleges of Chicago (CCC) announced its intention to turn over the management of its entire finance and accounting operations to a private contractor. The private company will manage CCC's payroll, grants accounting,

accounts receivable and payable, financial reporting, fixed-asset accounting, purchasing, student billing, financial aid, and budget functions and activities. According to CCC Chancellor Wayne D. Watson, "This transition will greatly increase our effectiveness and enhance the quality of education for our students. It will also increase our value because City Colleges will now be competitive in this new era of change."[1]

Example. Government and not-for-profit organizations are in the early stages of allowing citizens and clients to do business with them over the Internet. Many traditional activities requiring the citizen or client to conduct business on-site or through the mail will now be conducted online. Some examples of these activities include the following:

- Payment of taxes and filing of returns
- Initial application and renew of licenses and permits
- Vehicle registrations and tag renewals
- Obtaining copies of records or deeds
- Payment of traffic or court fines
- Payment of service billings and billing/payment research

Internet companies are in significant competition for this emerging area of electronic commerce (e-commerce). Government and not-for-profit organizations should be aware of the possible performance improvements that could be achieved through introducing competition into e-commerce activities.

Once the initial target function or activity is identified, the process of introducing competition should proceed with the formation of a competition task team, a qualitative analysis to further analyze the target function's or activity's competition potential, and the determination of the most appropriate competition strategy or approach. The ultimate charge of the competition project is to make a recommendation to an evaluation committee about whether the target function or activity is better provided through in-house service delivery or through an outside contractor or provider.

The Competition Task Team

The primary objective of the competition task team (the team) is to coordinate the continued tasks in the competition process. The team may select the most appropriate competition strategy or method, coordinate the competitive proposal process, review logistics and personnel plans, review cost comparisons, make the provider selection recommendation, and oversee the project monitoring process.

Regardless of the role of the CPA or CPA firm in the competition process, the team members should possess a wide range of experience in many disciplines. Individuals with practical experience in the target function or activity service delivery are important for inclusion. In addition, individuals with financial and cost accounting experience are essential. Representatives from the following government or not-for-profit organization's functional areas should be considered:

[1] National Association of College and University Business Officers, Web site article, "City Colleges of Chicago Outsources Finance Operations," January 2001.

- Budget and finance
- Procurement
- Human resources
- The specific target function
- Customers, constituents, or clients
- Employees or employee union

The team will need to select a team leader, who will be responsible for coordinating the team's activities and meetings throughout the entire project. This leader should ideally be the individual who is the most independent in terms of the effect of introducing competition into the target function or activity. An independent CPA would be a good candidate for this function. Alternatively, the CPA could serve as a consulting resource to the team leader. If the CPA is asked to assist the government or not-for-profit organization in selecting the members of the competition task team, sufficient consideration should be given to ensuring an appropriate mix of team members to include both the recommended representatives and external or internal CPAs.

In addition, the team should identify and add a transition leader, who will be responsible for implementing and managing the contract if an entity other than the current government or not-for-profit organization provides the service or the service is sold as a result of the competition process. Appointing the transition leader early in the life of the team will enable the individual to become familiar with the project and its goals and participate in defining the transition and monitoring process. This should facilitate a smooth implementation if a change is made. The transition leader would likely be an individual employed by the government or not-for-profit organization familiar with the target function or activity. The independent CPA can also be effective as a consulting resource for the transition leader, especially in the area of contract performance measurement and monitoring.

THE QUALITATIVE ANALYSIS

Once a target function or activity has been selected and a competition task team formed, the CPA or CPA firm should assist the task team in performing a qualitative analysis to determine the target function's or activity's potential for having competition introduced. This analysis should consider the factors that can affect the consideration of introducing competition as they relate specifically to the target function or activity (see the section titled "Factors for Successful Introduction of Competition," earlier in this chapter). For each of these factors, blank Competition Profile Forms assist in the analysis (see exhibit 2.1). (See the following section titled "Profile Forms" for instructions on the completion of these profile forms.) An illustrated example of a profile form completed for one of the factors is included (see exhibit 2.2), as well as an illustrated summary matrix of all the forms (see exhibit 2.4).

Profile Factors

The qualitative analysis includes the completion of a competition profile form for each of these factors:

- *Strength of the competitive market.* Market strength identifies the commercial characteristics of the target function or activity. Private sector interest and ability to provide the target function or activity service are key components.
- *Quality of service.* Quality of service reflects the expected effect that the introduction of competition will have on the effectiveness, timeliness, and thoroughness of the target function or activity being considered.
- *Control/oversight.* Control/oversight considers the entity's ability to oversee the provision of the services of the target function or activity if competition were to be introduced and another party were to perform the service.
- *Risk/exposure.* Risk/exposure considers the degree to which introducing competition exposes the entity to negative results, including legal or financial exposure, service disruption, corruption, and other risk factors.
- *Legal barriers.* Legal barriers take into account the effect that any laws, regulations, or other legal requirements may have on a decision to introduce competition into the target function or activity.
- *Political resistance.* Political resistance anticipates the amount of opposition to change in who provides the target function or activity service. The resistance can come from the public, users of the service, employee labor unions, interest groups, donors, governing or oversight bodies, and public officials.
- *Impact on employees.* This factor considers the impact that introducing competition into the target function or activity will have on the government or not-for-profit organization employees. Issues include the number of workers affected, whether workers will be displaced, and the ability of a contractor to hire the affected employees.
- *Resources.* This factor deals with the availability of resources to the potential competitors to help ensure the needed expertise and facilities or equipment and time to provide the target function or activity service.

Profile Forms

The CPA or CPA firm should assist the competition task team in completing the competition profile forms. Profile forms contain a series of questions and a list of mitigation suggestions that should be considered in arriving at a factor rating (ranging from +3 to –3). (See exhibit 2.1 for a blank competition profile form for each of the eight factors discussed in the preceding section.)

Completing the Forms

There are three steps to follow in completing a profile form.

Step 1. First review the "Questions to Be Considered" portion of the form. Then answer the questions by circling either the plus or minus sign in the "Yes" or "No" columns. A circled plus sign under a Yes or No indicates an answer that promotes competition related to that factor, whereas a circled minus sign indicates an answer that will likely not promote competition.

Step 2. Once the questions have been answered, evaluate the answers for the purpose of making the best professional judgment about the overall potential of the evaluated factor in promoting successful competition. A +3 represents a high potential for introducing competition successfully, whereas a rating of -3 indicates the lowest potential for success.

Step 3. If the result of the overall evaluation indicates the factor does not likely promote competition (for example, an overall rating of zero through -3) but the decision is to pursue competition further anyway, review and consider the "Mitigation Suggestions" section at the bottom of the form.

A completed profile form indicates the factor's potential. For example, the questions on a form for the strength of the competitive market might result in five positive factors (circled plus signs) and only one negative factor (circled minus signs). (See exhibit 2.2 for an example of a completed profile form for strength of the competitive market.) As a result, using professional judgment, the assignment of +3 would be made at the top of the form, indicating a high potential for promoting competition as it relates to the evaluated strength of competitive market factor.

Summarizing the Forms

Upon completion of the eight individual profile forms, summarize the forms. A profile summary matrix is useful in summarizing the eight factor ratings (see exhibit 2.3). Once completed, the profile summary matrix becomes the focal point for making the decision about whether to continue with the process of considering the introduction of competition into the target function or activity.

There are two steps required to complete the matrix:

Step 1. First, transfer the ratings from the individual profile forms to the summary matrix by circling the corresponding rating. Then draw a line that connects all the circled ratings. If the majority of the line rests on the right-hand side of the summary matrix, consider the target function or activity a candidate for the introduction of competition. A left-side majority suggests that the introduction of competition into the target function or activity may be less successful.

Step 2. Completion of the summary matrix yields an initial estimation of the competition potential of the target function or activity. If the analysis were considered complete at this point, it would assume all eight factors are equally important. In reality, each project is unique, thus the relative importance of its qualitative issues differ. Weighting the qualitative ratings better quantifies the relative importance of each factor rating. On the summary matrix, place a number (1, low, to 4, high) next to the relative importance of each factor to the target function in the "Weight" column. Then multiply the rating score by the assigned weight and place the result in the "Weighted Score" column. Once all the weighted scores have been calculated, add the "Weighted Score" column to determine its net total. The more positive the total, the greater the potential for successful introduction of competition. Completion of the qualitative analysis is the first formal decision point in the competition process.

A total weighted score of +6, for example, might indicate the target activity is a good candidate for the introduction of competition, and a decision to proceed with the competition project is appropriate. (See exhibit 2.4 for a completed profile summary matrix.)

COMPETITION STRATEGIES AND THE SELECTION PROCESS

Upon completion of the qualitative analysis, a decision by the competition task team is made about whether to further introduce competition into the government or not-for-profit organization for the specific target function or activity. If the resulting decision from the qualitative analysis is to either retain or reengineer the target function or activity, there is no further consideration of a competition strategy or approach needed at this time. However, if the resulting decision is to further introduce competition, the competition task team must decide on the most appropriate competition strategy or approach. The following are the most commonly considered competition strategies or approaches.

Contracting Out

Contracting out is a form of outsourcing that involves the hiring of another party to provide goods or services for the contracting entity. Competition for providing the goods or services is among outside providers. Under this approach, a government or not-for-profit organization remains the financing entity and has management and policy control over the type and quality of goods or services to be provided. Thus contractors that do not perform well can be replaced.

> **Example.** A not-for-profit organization decides to hire an independent contractor to provide meal delivery services to senior citizens, rather than acquire vehicles and use employee labor and other materials.

Managed Competition

The concept of managed competition is a relatively new competition strategy. Under a managed competition approach, a government or not-for-profit organization competes with private-sector firms or other governments and not-for-profit organizations to provide services under a controlled or managed process. This strategy clearly defines the steps to be taken by government or not-for-profit organization employees in preparing their own approach to performing the target or function activity. The government or not-for-profit organization's proposal, which includes a cost-estimate bid, is used to compete directly with other proposing entities. Managed competition can ultimately result in the government or not-for-profit organization taking any one of the three broad alternative actions (see chapter 1), including privatization, retention, or reengineering.

> **Example.** A state transportation department competes with private construction contractors through a formal bid process for the ability to perform a state highway expansion project. As a result of the competition process, the state elected to retain the project in-house and use state employees and equipment.

> **Example.** The custodial services department of a not-for-profit organization submits a competitive proposal, along with potential outside providers, to provide custodial services for a new office building. Based upon the proposal evaluation results, an outside contractor was selected for the custodial services.

Vouchers

Vouchers are a form of outsourcing that involves financial subsidies given to individuals for purchasing goods or services from the available providers. A government or not-for-profit organization gives individuals certificates or vouchers to purchase the goods or services in the open market. Under this approach, the vouchering entity relies on the market competition for cost control and the individuals to seek out quality goods or services. The vouchering entity's financial obligation to the recipient is limited by the amount of the voucher.

Example. A county government provides certificates for the purchase of child care services on the open market instead of providing such services through its own agencies or departments.

Partnerships

Sometimes referred to as a joint-venture, a partnership is an outsourcing approach that involves a contractual agreement formed among governments, not-for-profit organizations, and private sector partners, or some combination of those entities. This arrangement can involve a variety of activities, including the development, financing, ownership, and operation of a government or not-for-profit facility or service. In such a partnership, resources are pooled and their responsibilities divided so each partner's efforts complement one another. Such a venture, although a contractual arrangement, differs from contracting out in that a private-sector partner usually makes a substantial at-risk equity investment in the project, and a government or not-for-profit organization partner may gain access to new revenue or service-delivery capacity without having to pay the other partner(s).

Example. A state agency owns an outdated, historic building in a highly desirable downtown location. It leased the building to a private developer, which renovated the building for commercial office space. The state agency earns revenue from its lease with the developer, and the developer earns revenue from renting out the commercial space in the renovated building.

Franchising

Franchising is a form of outsourcing that involves a government or not-for-profit organization granting an exclusive right to a private business to provide a government or not-for-profit organization service in a certain geographical area. Normally the government or not-for-profit organization requires the franchisee to pay a fee for such right.

Example. A local government outsources its natural gas utility service to a private gas company. The gas company pays an annual franchise fee to the government equal to a contractually specified percentage of its gas sales within the franchise area.

Volunteerism

Volunteerism is a form of outsourcing that involves volunteers performing all or a part of a government or not-for-profit organization's function or activity. This method of outsourcing can involve informal volunteer services or a formally structured volunteer program.

Example. A not-for-profit museum uses volunteers as its tour guides. The tour guide service is a formal volunteer program created and controlled by the management of the not-for-profit organization.

Service Shedding

Shedding is a form of divestiture in which the government or not-for-profit organization reduces the level of service provided or stops providing a service altogether. Private-sector businesses or other government or not-for-profit organizations may step in to provide the service if there is a market demand.

> **Example.** Based on limited demand for service by customers and limited interest by private-sector businesses in performing the service, a not-for-profit organization elected to discontinue providing its marriage counseling service.

Asset Sale or Lease

Another divestiture approach is an asset sale or lease arrangement. An asset sale or lease involves the ultimate transfer or sale of assets owned by government or not-for-profit organizations to the private sector or other outside provider. In general, the government or not-for-profit organization will have no role in the financial support, management, or oversight of the asset sold or transferred. However, if the asset is sold or transferred to a company in an industry with monopolistic characteristics, the government or not-for-profit organization may still regulate certain aspects of the business, such as the regulation of utility rates for a utility system sold to a private company.

> **Example.** A municipality determined that it no longer desired to own and operate a local hospital. Through a competitive bid process, the hospital was sold to a private-sector business. Upon sale, the municipality no longer had a role in the hospital operation. The sale proceeds were placed in trust and held for five years, the term of a buy-back clause. After the five-year period, if not bought back, the proceeds could be used for other capital improvements.

Criteria for Selecting the Appropriate Competition Strategy

When deciding which competition strategy is the best approach or method, the results from performing the target function's or activity's qualitative analysis, as discussed earlier in this chapter, should be used by the CPA or CPA firm in advising the competition task team. If the function or activity has several service delivery components, it may be necessary to consider a combination of methods or strategies rather than selecting a single one. Some questions that will assist the decision makers in selecting the best strategy follow.

Who Is the Customer and How Many Customers Need Service?

If the customer is the government or not-for-profit organization, the service delivery lends itself to contracting out or managed competition. The voucher approach would work better when services are delivered directly to a large number of customers or constituents and where a large number of suppliers is available.

What Is the Nature of the Service?

If the service provides direct assistance to the customer, a voucher approach may be preferable because it allows greater choice to the customer in selecting the service provider. If the service is not considered a typical government or not-for-profit organization-provided service, a service shedding, asset sale or lease, or a partnership approach may be the best strategy.

How Many Qualified Providers Are Available to Provide the Service?

The voucher, contracting out, and managed competition approaches require a larger number of qualified providers than the other approaches. Voucher systems in particular need a large number of providers in order to provide numerous choices for the customer.

How Important Is Direct Control Over the Service Delivery?

If direct control is important, contracting out, managed competition, franchising, and volunteerism are likely the best strategies. On the other hand, vouchers, service shedding, and asset sale or lease approaches work better when less government or not-for-profit organization control is necessary and less regulation exists.

CONCLUSION

CPAs possess the organizational, analytical, and project management skills that are needed to assist a competition task team in identifying and defining potential target functions or activities, analyzing their potential for successful introduction of competition, and selecting the most appropriate competition strategy. Successful use of competition must begin with the identification of opportunities to compete and the evaluation of certain factors that will assist the decision makers in determining the target function's or activity's potential for having competition introduced.

An essential task in this phase of the competition project is the performance of the qualitative analysis that assists the decision makers in evaluating and documenting the considerations made in determining the target function or activity's competition potential. The results of the qualitative analysis generally determine whether to retain the function or activity in-house with little or no modification, retain the function or activity and reengineer it, or further proceed with the introduction of competition. If the decision is to proceed further with the introduction of competition, the most appropriate competition strategy or approach must be selected, such as contracting out, managed competition, vouchers, partnerships, franchising, volunteerism, service shedding, or asset sale or lease.

Exhibit 2.1

Example Competition Profile Forms*

The competition profile forms are used in conducting the qualitative analysis. These forms are completed and summarized on the profile summary matrix (see exhibit 2.3) to determine whether the target function or activity is a good candidate for the introduction of competition. The forms include a profile for the following factors:

- Strength of Competitive Market Profile Form (See exhibit 2.2 for a completed example form.)
- Quality of Service Profile Form
- Control Profile Form
- Risk Profile Form
- Legal Barriers Profile Form
- Political Resistance Profile Form
- Impact on Employees Profile Form
- Resources Profile Form

* **Source: Adapted from the State of Arizona *Competitive Government Program Handbook*, July 2000, Governor's Office for Excellence in Government. These forms are included for your convenience and information only. Periodically, the state updates or changes the forms that were adapted for this publication. You should check the Arizona Web site (www.governor.state.az.us/excellence) if you have an interest in any updates that the state may have made to the forms since this publication was issued.**

Exhibit 2.1 *(continued)*

1. Strength of Competitive Market

-3__________-2__________-1__________0__________+1__________+2__________+3

Low Potential	**High Potential**

Definition: Market strength denotes the commercial characteristics of the target function or activity. Outside contractor or provider interest and ability to provide the service are key components.

Questions to Be Considered:

	Yes	No
• Are there multiple capable outside contractors or providers available?	+	–
• Are there multiple interested contractors or providers?	+	–
• Is the nature of the financial commitment so large or small that potential contractors or other providers may not be interested?	–	+
• Will contracting out result in a monopoly?	–	+
• Is the nature of the target function or activity highly complex?	–	+
• Are the current wages in this area, compared to outside providers or other jobs within the entity, causing high personnel turnover?	+	–

Mitigation Suggestions if the Market Strength Does Not Promote Competition:

- Share the responsibility for provision of the service among contractors or between the government or not-for-profit organization and a single contractor.
- Expand the number of contractors to decrease the chance of a monopoly forming.
- Write the request for proposals to ensure multiple contractors and competition exist.
- Determine if long-term contracts can be written to facilitate recoveries of investments for contractors.
- Break down the size of the service into smaller projects. In high-risk services, pilot project contracts may be desirable before full-scale competition is attempted.

Exhibit 2.1 *(continued)*

2. Quality of Service

-3__________-2__________-1__________0__________+1__________+2__________+3

Low Potential — **High Potential**

Definition: Quality of service reflects the expected effect privatization will have on the effectiveness, timeliness, and thoroughness of the target function or activity being considered for competition.

Questions to Be Considered:

	Yes	No
• Will quality decrease as a result of contracting out?	–	+
• Will contracting out compromise the public trust, safety, or welfare?	–	+
• Will contracting out threaten patient or client confidentiality or the ability to treat patients or clients with impartiality?	–	+
• Will accountability and responsiveness by the government be decreased by contracting out?	–	+
• Can well-defined objectives be included in a contract?	+	–

Mitigation Suggestions if the Quality of Service Profile Does Not Promote Competition:

- Place more emphasis on oversight for quality control.
- Include formal periodic customer ratings of the contractor's performance.
- Build in incentives to providers for quality service.

Exhibit 2.1 *(continued)*

3. Control

-3__________-2__________-1__________0__________+1__________+2__________+3

Low Potential — **High Potential**

Definition: Control considers the government or not-for-profit organization's ability to oversee the provision of the target function or activity.

Questions to Be Considered:

	Yes	No
• Is it important for the agency to control the delivery of the target function or activity?	–	+
• Does the agency have the ability to develop and maintain control mechanisms over the target function or activity if it is privatized?	+	–
• Is the quality and quantity of the target function or activity service relatively easy to measure?	+	–

Mitigation Suggestions if the Control Profile Does Not Promote Competition:

- Increase control through detailed contract specifications.
- Require that the contractor maintain records that allow easy oversight and evaluation.
- Teach contract writing, management, and evaluation skills to employees charged with control, oversight, and monitoring.
- Develop a thorough monitoring plan before implementing the request for proposal and contract award phases.

Exhibit 2.1 *(continued)*

4. Risk

-3__________-2__________-1__________0__________+1__________+2__________+3

Low Potential	**High Potential**

Definition: Risk is the degree to which using outside contractors exposes the government or not-for-profit organization to additional hazards, including legal or financial exposure, service disruption, corruption, and other risk factors.

Questions to Be Considered:

	Yes	No
• Are the chances high that the contractors will fail to complete the contracts?	–	+
• Will the consequences of any service interruptions be major?	–	+
• Will there be increased legal exposure as a result of contracting out?	–	+
• Will contracting out result in an increased risk of corruption?	–	+
• Will contracting out result in risk sharing with the contractor?	+	–
• Will the contractor be able to indemnify the agency?	+	–
• Will the contractor be singularly responsible for any and all cost overruns?	+	–

Mitigation Suggestions if the Risk Profile Does Not Promote Competition:

- Write contract provisions to reduce the risk of service interruption by including reporting requirements, liquidated damage clauses, or both.
- Maintain ownership of capital equipment.
- Develop an emergency plan to deal with interruptions in service.
- Rent critical equipment and facilities to the outside contractor.
- Maintain a list of alternative providers.
- Slowly phase in privatization until it is certain that contractors are capable and reliable.
- Include cost adjustments into the contract for inflation and increased service requirements.

Exhibit 2.1 *(continued)*

5. Legal Barriers

-3__________-2__________-1__________0__________+1__________+2__________+3

Low Potential	**High Potential**

Definition: The effect that any laws, regulations, or other contractual requirements may have on a decision to introduce competition into the target function or activity.

Questions to Be Considered:

	Yes	No
• Is the mode of service delivery mandated by law, regulation, or contract?	–	+
• Must laws or rules be changed to permit outsourcing of the target function or activity?	–	+
• Is outsourcing compatible with the legislative, commission, or board intent that created the target function or activity?	+	–

Mitigation Suggestions if the Legal Barriers Profile Does Not Promote Competition:

- If the scale is tipped away from competing, the legal limits may relate to only small portions of the target function or activity that might be separated from the privatization portion.
- If laws need to be changed, assess the difficulty of doing so. Is the legislative climate conducive to supporting change? Are there sponsors willing to support needed legislation?

Exhibit 2.1 *(continued)*

6. Political Resistance

-3__________-2__________-1__________0__________+1__________+2__________+3

Low Potential	**High Potential**

Definition: Political resistance anticipates the amount of opposition to change in who provides the target function or activity service. This resistance can come from the public, users of the target function or activity, interest groups, or public officials.

Questions to Be Considered:

	Yes	No
• Are concerned citizens, service recipients, interest groups, public/elected officials, or board members highly resistant to change?	–	+
• Do citizens, service recipients, interest groups, or public/elected officials or board members want the service to be provided in-house?	–	+
• Does the target function or activity have low overall political support?	+	–
• Are there any current problems with in-house delivery?	+	–

Mitigation Suggestions if the Political Environment Does Not Promote Competition:

- Reduce resistance by designing compromises in contracts or agreements.
- Reschedule implementation until a better time of year or date to avoid the resistance.
- Focus on services that the government or not-for-profit organization is not satisfactorily providing.
- Involve various interested groups in the decision-making process.

Exhibit 2.1 *(continued)*

7. Impact on Employees

-3__________-2__________-1__________0__________+1__________+2__________+3

Low Potential — **High Potential**

Definition: The impact that introducing competition into the target function or activity will have on the government or not-for-profit organization's employees.

Questions to Be Considered:

	Yes	No
• Will contracting out negatively affect employees?	–	+
• Will a large number of employees be affected?	–	+
• Will the contractors be required to hire displaced employees?	+	–
• Will any employees choose buy-out options?	+	–
• Will any employees be involuntarily terminated?	–	+
• Will civil service policies, such as Affirmative Action, be weakened as a result of outsourcing?	–	+

Mitigation Suggestions if the Impact on Employees Profile Does Not Promote Competition:

- Provide job transfers into other employment opportunities.
- Provisions can be written into contracts that ensure that some civil service policies, such as affirmative action and due process, are carried out by the provider.
- Include a provision in the contract to ensure that the contractor gives displaced employees the right-of-first refusal.
- Provide employees with early retirement options.

Exhibit 2.1 *(continued)*

8. Resources

-3__________-2__________-1__________0__________+1__________+2__________+3

Low Potential | **High Potential**

Definition: The efficient and effective use of government assets (for example, personnel, funding) is reflected within this criterion. This includes in-house or private sector advantages in terms of professional expertise, facilities or equipment, time constraints, and revenue or expenditure restrictions.

Questions to Be Considered:

	Yes	No
• Do the competitors have access to needed expertise that the government or not-for-profit organization does not?	+	–
• Do the competitors possess needed facilities or equipment that the government or not-for-profit organization does not?	+	–
• Are there other resource advantages that the competitors have that the government or not-for-profit organization does not?	+	–
• Do time constraints exist that preclude in-house delivery?	+	–
• Will contracting out reduce required completion times?	+	–

Mitigation Suggestions if the Resource Profile Does Not Promote Competition:

- In cases where the government or not-for-profit organization has substantial equipment and facilities, examine whether selling or leasing is an option.
- Lease purchase agreements might be used so that the entity eventually takes ownership of the resources.
- Resources might be shared among departments for greater efficiency. For example, can departments share a privately provided printing service and save money?
- Better planning by the entity may help to avoid resource inefficiencies.

Exhibit. 2.2

Completed Example Competition Profile Form*

1. Strength of Competitive Market

Rating (circle the number corresponding to your overall rating):

-3__________-2__________-1__________0__________+1__________+2__________+3

Low Potential — **High Potential**

Definition: Market strength denotes the commercial characteristics of the target function or activity. Outside contractor or provider interest and ability to provide the service are key components.

Rating Characteristics:

The responses to the questions below will assist in the decision-making process and are weighted toward the –/+ side of the "Strength of Competitive Market" scale. Yes or no responses can indicate a favorable or unfavorable outcome depending on the scenario presented.

Note: A + indicates a yes or no answer that is favorable to competition.

A – indicates a yes or no answer that is unfavorable to competition.

For instance, a yes response to the question on wages (bullet item 6) could indicate that the requested function is suitable for outside competition since high personnel turnover is resulting from wage competition. A no response to the same question could indicate wages would not be an issue for losing staff to an outside provider or to other jobs.

Questions to Be Considered (Circle appropriate answer)

	Yes	No
• Are there multiple capable outside contractors or providers available?	+	–
• Are there multiple interested contractors or providers?	+	–
• Is the nature of the financial commitment so large or small that potential contractors or other providers may not be interested?	–	+
• Will contracting out result in a monopoly?	–	+
• Is the nature of the target function or activity highly complex?	–	+
• Are the current wages in this area, compared to outside providers or other jobs within the entity, causing high personnel turnover?	+	–

Mitigation Suggestions if the Market Strength Does Not Promote Competition

- Share the responsibility for provision of the service among contractors or between the government or not-for-profit organization and a single contractor.

* **Source: Adapted from the State of Arizona *Competitive Government Program Handbook*, July 2000, Governor's Office for Excellence in Government. This form is included for your convenience and information only. Periodically, the state updates or changes the forms that were adapted for this publication. You should check the Arizona Web site (www.governor.state.az.us/excellence) if you have an interest in any updates that the state may have made to the forms since this publication was issued.**

Exhibit 2.2 *(continued)*

- Expand the number of contractors to decrease the chance of a monopoly forming.
- Write the request for proposal to ensure multiple contractors and competition exist.
- Determine if long-term contracts can be written to facilitate recoveries of investments for contractors.
- Break down the size of the service into smaller projects. In high-risk services, pilot project contracts may be desirable before full-scale competition is attempted.

Exhibit 2.3

Example Profile Summary Matrix*

(See exhibit 2.4 for a completed example form.)

Profile Factor	Low Potential for Competition (Pro In-House)			High Potential for Competition (Pro Outside)			Relative Importance Weight 1=Low 4=High	Weighted Score
1. Strength of competitive market	–3	–2	–1	+1	+2	+3		
2. Quality of service	–3	–2	–1	+1	+2	+3		
3. Control	–3	–2	–1	+1	+2	+3		
4. Risk	–3	–2	–1	+1	+2	+3		
5. Legal barriers	–3	–2	–1	+1	+2	+3		
6. Political resistance	–3	–2	–1	+1	+2	+3		
7. Impact on employees	–3	–2	–1	+1	+2	+3		
8. Resources	–3	–2	–1	+1	+2	+3		
Total weighted score								

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Exhibit 2.3 *(continued)*

Comments or rationale: (Indicate decision and rationale regarding whether to proceed with introducing competition into the target function or activity.)

Exhibit 2.4

Completed Example Profile Summary Matrix*

Profile Factor	Low Potential for Competition (Pro In-House)	High Potential for Competition (Pro Outside)	Relative Importance Weight 1=Low 4=High	Weighted Score
1. Strength of competitive market	–3 –2 –1	+1 +2 +3	2	6
2. Quality of service	–3 –2 –1	+1 +2 +3	3	3
3. Control	–3 –2 –1	+1 +2 +3	2	–2
4. Risk	–3 –2 –1	+1 +2 +3	1	2
5. Legal barriers	–3 –2 –1	+1 +2 +3	1	3
6. Political resistance	–3 –2 –1	+1 +2 +3	4	–4
7. Impact on employees	–3 –2 –1	+1 +2 +3	3	–6
8. Resources	–3 –2 –1	+1 +2 +3	2	4
Total weighted score				**6**

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Exhibit 2.4 *(continued)*

Comments or rationale: (Indicate decision and rationale regarding whether to proceed with introducing competition into the target function or activity.)

A total weighted score of positive six indicates the target function or activity is a good candidate for the introduction of competition. While the impact on employees and the political factors have a negative affect on the consideration, they are mitigated by the other positive factors, including strength of market.

Chapter 3:
Planning to Introduce Competition

Successfully introducing competition requires early planning and preparation to address such considerations as the scope of the project, performance monitoring, the transfer of service delivery (if applicable), personnel concerns, and any concerns that stakeholder groups may have. In this chapter, the resulting decision from the qualitative analysis (as discussed in chapter 2) is assumed to be to proceed further with the introduction of competition into the target function or activity. In planning for the use of competition, the primary objective is to ensure that proper consideration is given to factors that will affect the implementation of the remainder of the project. In this phase of the project, an evaluation and determination of how the target function or activity is currently providing the service, and a determination of what will be done to provide the service in the future, are made. This planning and preparation is essential to realize the ultimate goals of improving performance and cost-effectiveness. This chapter provides considerations likely to influence the manner in which the competition project proceeds.

If a target function or activity has not yet been selected or the most appropriate competition strategy or approach has not been identified, see chapter 2, "Identifying Opportunities for Introducing Competition." This chapter focuses on how to finalize the project scope and plan for project implementation, including—

- How to meet with potential competing vendors or entities to determine the scope of the target function or activity's service and the level of interest in providing such service.
- How to develop a performance monitoring plan to monitor achievement of the project's goals and objectives and possible use in supporting performance incentives, sanctions, or both.
- How to develop a plan to address the logistics of transferring the target function or activity's service to another provider, if applicable.
- How to develop a personnel plan to minimize the disruption to affected employees.
- How to address the concerns of the interested parties or stakeholders affected by the target function or activity.
- How to make a determination about whether to proceed with the next phase of the project—the cost analysis (see chapter 4).

Significant attention is given to developing performance measures and a performance monitoring plan because these are essential for determining the overall success of the project.

HOW TO DETERMINE THE SPECIFIC PROJECT SCOPE

Once the target function or activity has been identified, the scope of service to be considered for competition must be specifically defined.

Example. A university is planning to introduce competition into the bookstore function. Although the university's bookstore function may have been targeted, a specific determination of which bookstore activities to include, if not all, and a definition of the specific responsibilities of the parties involved in the potential contract must be made. Certain issues should be addressed in determining the bookstore project scope.

- Define the problems to resolve or desired outcomes to achieve by considering competition in bookstore services.
- Confirm that there are a sufficient number of competitors interested in providing the services to protect against monopolistic practices.
- Identify any bookstore activities that the potential competitors are interested in performing.
- Identify any additional bookstore services or activities the potential competitors could provide that are not currently available from the university.
- Determine whether the interested competitors will allow the university to establish the days and hours the bookstore would be open.
- Confirm that the interested competitors will agree to include performance measures, such as competitive prices and student satisfaction, in the contract.
- Determine whether any current or new facilities and equipment will be required by the potential competitors from the university.
- Define the most desirable contract term or period of time.
- Determine whether outside contractors will hire some or all of the existing bookstore employees and to what extent.

In determining the specific scope of the competition project, certain tasks must be performed that address such issues as desired project outcomes, the contract period, the specific services or deliverables, and acceptable performance standards.

Essential Tasks to Determine the Project Scope

The specific scope of the project is defined by the results of the qualitative analysis performed (see chapter 2) and the essential tasks (discussed below) that must be performed to achieve the expected outcomes from the introduction of competition. Essential tasks of the CPA or CPA firm assisting the competition task team involved in determining the specific scope of the project include—

- *Understanding the target function or activity.* Understand the target function's or activity's service, its mission and objectives and how it operates.

Example. A county government is considering introducing competition into its tax billing and collection function. In determining specific project scope, it is important for the CPA advising the competition task team to define the specific taxes to include, and to understand any legal requirements applicable to the taxes, and the government's current policies and procedures. In this case, after careful consideration of these factors, the competition task team, with the CPA's help, identified property taxes, beverage taxes, and vehicle taxes as the best candidates for introducing competition.

- *Defining the competition objective.* Define the desired outcomes of this competition project.

Example. In an effort to define the desired outcomes of introducing competition, the specifically selected tax billing and collection functions of the county government must be evaluated by the CPA as to the problems to resolve or issues to address. In this case, the results of the evaluation indicate the county has been experiencing a high number of billing errors and an increasing trend of delinquent tax collections. In addition, the tax department budget has grown at a rate significantly higher than the rate of growth in the number of taxpayers. Therefore, the CPA has advised the competition task team that the desired outcomes from introducing competition are to achieve a reduction in the billing error rate, improve collections, and lower costs in providing the service.

- *Determining contract period.* Specify the length of time the contract with the selected provider should run for a service, or specify a completion date if the project involves a deliverable product rather than a service.

Example. Because the tax billing and collection process is a service, a contract period of time should initially be established. In this case, because the contractors will likely not have to incur significant one-time costs to provide this service, the CPA has advised the competition task team to be flexible in negotiating a contract period. A period of more than one year is desirable in this case to allow for billing and collection trends to be evaluated for performance.

- *Identifying service tasks or deliverable products.* Identify the details of the work to be performed, including significant deadlines, milestones, and deliverables, and any special knowledge or skills needed to achieve them.

Example. As noted earlier, the county's competition task team identified the billing and collection of property taxes, beverage taxes, and vehicle taxes as the specific activities for introducing competition. Because different processes and requirements are applied to the various taxpayer groups (for example, commercial versus residential), different processes and requirements must be described. In this case, the CPA defined the milestones and deadlines affected by legal requirements and the dates applicable to tax billing and collection. In addition, the CPA defined the specific deliverables concerning the billing content and presentation; collection; and deposit methods, such as use of checks, wire transfers, direct deposits, bank drafts, and reporting formats.

- *Specifying acceptance standards.* Specify the performance criteria and standards for accepting the work so a basis for rejecting unsatisfactory delivery or results or for implementing sanctions will exist.

Example. Because the problems to be resolved in the county's tax billing and collection function are the high billing error rate, increasing delinquent collections, and increasing costs of service, the performance measures should be focused on these areas. Therefore, in this case, the CPA advised the competition task team that desirable performance measures should include—

- Number of bills prepared per $1,000 of contract cost.
- Number of billing errors per 1,000 bills prepared.
- Percentage of taxes collected compared to taxes levied.

In addition to these measures, other performance indictors were included, such as reporting timeliness, reporting accuracy, and taxpayer satisfaction in the process.

- *Obtaining input from outside providers.* Conduct an initial meeting with prospective providers or consider submitting a request for information (RFI) to outside providers interested in performing the target function or activity. This allows the government or not-for-profit organization to obtain input without committing the organization to any action. Interested outside provider representatives are invited to discuss the target function or activity from a logistics and operational perspective and to raise questions, in a noncompetitive and nonbinding environment. A representative group of potential outside providers should be included in this process. Based on the result of these meetings, it should be clear whether outside providers are interested in competing for the target function or activity and how they might approach service delivery. If sufficient outside provider interest is not present, the project should be terminated or redirected toward improving effectiveness and efficiency through methods other than privatization, such as reengineering (see chapter 1).

  Example. The CPA advising the competition task team held an initial planning meeting with the outside providers in an effort to determine the interest level and number of potential outside providers; explain the initial scope of work to them; and discuss deliverables, deadlines, and desired performance outcomes. The information obtained from this meeting allowed the county's competition task team, with the CPA's help, to change the scope of service, as follows, and produce information to be used in the formal request for proposal (RFP).

- *Finalizing the project scope.* Finalize the project scope based on the information obtained from performing the tasks above. Remember that the scope of the project was initially defined when the target function or activity was considered using the qualitative analysis as defined in chapter 2. The results of the previous tasks may provide additional information resulting in the need to consider changes to the project's initial scope.

  Example. As a result of the CPA performing the previous tasks, the county's competition task team learned that there was insufficient interest from qualified vendors to contract for the entire billing and collection functions of property, beverage, and vehicle taxes. Only one local vendor was interested in contracting for the entire function, and that vendor had little experience. However, several qualified vendors showed considerable interest in collecting delinquent taxes on behalf of the county. Therefore, the competition task team decided to narrow the scope of the competition project to include only the collection of delinquent property, beverage, and vehicle taxes. Other activities related to billing, deposit, and reporting will be retained in-house with a plan to reengineer the processes to become more efficient and effective.

The remaining activities involved in preparing for competition cannot proceed without a clearly defined project scope. After the specific scope is defined, initial planning should be conducted in the areas of performance monitoring, service transition, and dealing with affected personnel. The purpose of this initial planning is to outline how the selected service provider's performance will be measured; how the target function or activity will be transferred, if applicable; and what personnel changes will be necessary, if any. These issues should be considered early in the process for a complete and comprehensive RFP to be prepared. (A more complete discussion of the RFP process and an example RFP are provided in chapter 4, "The Cost Analysis: A Step-by-Step Approach.")

HOW TO DEVELOP A PERFORMANCE MONITORING PLAN

A performance monitoring plan is critical to the continued successful operation of the target function or activity. Unless a decision is made to eliminate the target function's or activity's service, the government or not-for-profit organization will still be required to provide what its customers, constituents, taxpayers, donors, or clients (hereafter referred to as the service recipients) have paid for, whether through its own service delivery or some form of outsourcing. Performance monitoring will enable the government or not-for-profit organization to measure how well it (or the outside provider in the event the target function or activity is outsourced) is meeting the service recipients' expectations.

Monitoring Plan Objectives

An entity considering competition should be able to answer the following questions of itself and its potential outside providers.

- Are we getting the type and level of service that we expect?
- Are our service recipients satisfied?
- Is the function or activity cost-effective?

Sound performance measures will provide the answers to these questions. With the exception of eliminating the function or activity through divestiture (as discused in chapter 1), regardless of whether the government or not-for-profit organization privatizes, retains, or reengineers the function or activity, it cannot abdicate its responsibility for service recipient satisfaction.

Developing Performance Measures

Written performance measures, agreed upon by the interested providers, are essential to effective performance measurement. Obtaining competing parties' concurrence with measurable standards of performance is an essential step in the development of a performance monitoring plan.

Performance measures will be used to—

- Define the standards for measuring service delivery, such as achieving a certain level of customer satisfaction or serving a specified number of customers within a certain time period.
- Ensure that the service is being appropriately delivered, for example, ensuring the sanitation customer's refuse is collected at required intervals.

- Measure customer satisfaction with the provider, by establishing a benchmark, such as the current level of satisfaction, as a minimum.
- Supply the data for evaluations, audits, and contract amendments, to enable more effective and timely monitoring through periodic reporting of the measures.

Performance measures generally include the following indicators:

- *Inputs*—Indicators of the amount of resources, including financial and personnel, that have been used in providing the target function or activity

  Example. Budgeted dollars and number of personnel or hours used to provide student instruction

- *Outputs*—Indicators of the number of units produced or services provided by the target function or activity

  Example. Number of student days, number of students promoted or graduated, and absenteeism and dropout rates

- *Outcomes*—Indicators of the effectiveness of the service provided, such as whether the goals have been achieved

  Example. Change in student test scores, percentage of students achieving specified testing standards, and percentage of graduates gainfully employed after training

- *Efficiencies*—Indicators that measure the efficiency of the service delivery through comparing cost or other inputs per unit to outputs

  Example. Number of student days in relation to the number of teachers or in relation to dollars spent

- *Cost-effectiveness*—Indicators that measure the cost-effectiveness of the service delivery through comparing cost or other inputs per unit to outcomes

  Example. Number of students achieving target test scores in relation to the number of teachers or in relation to the dollars spent

(Table 3.1 includes example performance indicators for input, output, outcome, efficiency and cost-effectiveness measures applicable to a chronic disease treatment function of a government or not-for-profit organization considering competition.)

TABLE 3.1 EXAMPLE PERFORMANCE INDICATORS (CHRONIC DISEASE TREATMENT FUNCTION)

Indicator	Rationale for Selection
Inputs:	
• Program expenditures • Number of staff involved	Measure of resources used to provide the service
Outputs:	
• Number of patients treated • Number of persons screened • Number of education program participants • Number of treatment sessions • Average worker-hours per client • Percentage of target population served	Widely accepted measures used by public health professionals to measure program outputs
Outcomes:	
• Change in mortality rates	Measure of death due to chronic disease Measure of program effectiveness
• Target group with controlled conditions • Restricted activity days per person • Bed disability days per person	Indication of quality of life after onset of chronic disease
• Percentage of patients in target group with controlled conditions	Indication of the accomplishment of short-term program objectives
Efficiencies:	
• Cost of medical supplies per unit of service	Measure of efficiency in acquisition of supplies
• Projected costs saved/prevention program costs	Indication of efficiency in reducing future costs
Cost-effectiveness:	
• Program costs/number of patients with controlled chronic disease	Indication of agency's costs in achieving each controlled case
• Program hours per controlled chronic disease case	Indication of effectiveness of the hours used to achieve each controlled case

Source: Adapted from *Service Efforts and Accomplishments: Its Time Has Come,* Exhibit 10-1, a Governmental Accounting Standards Board Research Report, 1990; pp. 228–229.

The Governmental Accounting Standards Board (GASB) maintains a comprehensive Web site (www.gasb.org) that provides extensive information, example case studies, and other Internet links on performance measurement in government. Although the site does not address developing performance measures specifically related to the use of competition, the site still provides a wealth of information that should be helpful. Also, while the Web site is designed to provide information for governmental entities, the site and its information are likely to be equally useful to not-for-profit organizations. (See table 3.2 for functions that have performance measures and Web site links provided in the GASB Web site.)

TABLE 3.2 GASB WEB SITE PERFORMANCE MEASUREMENT FUNCTIONS

Administration	General government
Aging	Health care and hospitals
Child and domestic welfare	Homeless services
Colleges and universities	Housing and community development
Community indicators	Libraries
Consumer protection	Mass transit
Correctional services	Mental health and substance abuse
Criminal justice	Parks
Cultural programs	Police
Disabilities	Public assistance
Early childhood education	Public health
Economic development	Regulatory services
Economics and demographics	Road maintenance
Elementary and secondary education	Sanitation
Environmental protection	Transportation
Financial administration	Water and wastewater treatment
Fire services	Workforce development
Foster care	Youth programs

The GASB Web site also includes a number of documented case studies from state and local governments that have implemented performance measurement. These case studies may be downloaded from the GASB Web site for detailed review. The case studies are quite comprehensive and define how performance measures are identified and used to monitor performance. Following is a discussion of an example from one such case study involving the City of Portland, Oregon.[1]

> **Example.** The benchmarks (or performance measures) were developed to gauge how well the City of Portland was progressing toward its vision and strategic plan. In 1999, they were tracking seventy-six benchmarks or measures in the Portland-Multnomah program in six clusters, including economy, education, children and families, quality of life, governance, and public safety. The Oregon benchmarks program tracked outcomes through ninety-two indicators. These benchmarks are a broad array of social, economic, and environmental health indicators, including K-12 student achievement, per capita income, air quality, crime rates, employment, and infant health.

In addition to the GASB Web site, a number of other resources, including publications and guides, are available regarding performance measurement in government and not-for-profit organizations (see chapter 7 for a listing of such references).

[1] Governmental Accounting Standards Board, *Performance Measures in Government—GASB's State and Local Government Case Studies: The Use and the Effects of Using Performance Measures for Budgeting, Management, and Reporting* (www.rutgers.edu/Accounting/raw/seagov/pmg/index).

Addressing Questions in Developing Performance Measures

Well-written and monitored performance measures are essential to a successful competition project. Some important considerations for developing effective performance measures include the following:

- Do the performance measures reflect the mission of the target function or activity?
- Are the performance measures written with the service recipient in mind?
- Do the performance measures emphasize outputs and outcomes rather than processes?
- Are the performance measures quantifiable, measurable, and obtainable economically?
- Do the performance measures clearly indicate how they will be calculated or measured and when and to whom they will be reported?

Defining Elements of a Performance Monitoring Plan

Performance monitoring requires the government or not-for-profit organization to interact with the selected provider and service recipient and enables timely corrective action when necessary. This minimizes the possibility of poor quality of service remaining undetected. Government and not-for-profit organizations should not wait until the end of the contract period to learn what problems exist in the contracted service, and for this reason, the entity should consider including the following elements in the performance monitoring plan.

Periodic Provider Reporting

The selected provider is required to submit detailed progress reports based on predefined measurement criteria. Performance data should be gathered periodically, at least annually, and not just at the end of the provider contract period. Without periodic reporting and review, the government or not-for-profit organization will not be able to learn of and address a problem that may exist internally or externally.

The provider-reporting component of the plan should address the following:

1. What data is to be submitted
2. How the data is to be submitted
3. To whom and when the provider is required to submit the data
4. What types of internal or external review or audit the data may be subject to
5. What actions the government or not-for-profit organization may take in response to the data evaluation

Financial and Compliance Monitoring

Financial and compliance monitoring is an integral part of a performance monitoring plan. Financial monitoring, such as provider invoice review, can help ensure costs being charged by the provider, including wages, equipment rates, and other charges, are within contract parameters. The level of financial monitoring considered necessary may vary depending on the type of contract, such as fixed-fee contracts versus cost-reimbursement contracts. For example, fixed-fee contracts require less financial monitoring than cost reimbursement contracts where reimbursements are based on incurring allowable costs. Even some cost reimbursement contracts may not require any significant financial monitoring, such as a contract in which reimbursements are based on the number of clients served regardless of the provider costs incurred. In these limited financial monitoring situations, the financial monitoring may be limited to testing the arithmetical accuracy of the contract invoices and determining that the payments are within contract limits.

In addition, if federal or state grant awards are used to fund some portion of the target function or activity, monitoring of compliance with award requirements may be required. The performance monitoring plan should address who will perform this monitoring, its frequency, and which party (the government entity, the not-for-profit organization, or the new provider) will pay for these services.

On-site Inspections

The government or not-for-profit organization should plan to include on-site inspections whenever possible.

> **Example.** Periodic on-site visits to a museum's gift shop whose operations have been outsourced to a private company can provide first-hand evidence of the company's operational performance and examples of customer service. The results of these visits should be reported and compared with contract requirements.

If on-site visits are not feasible, it may be advisable to include other forms of measuring service recipient satisfaction, such as surveys, interviews, or complaint monitoring.

Service Recipient Surveys, Interviews, and Complaint Monitoring

The government or not-for-profit organization may find it useful to survey or interview service recipients concerning service delivery satisfaction.

> **Example.** A city government that has outsourced the operation of its summer baseball program may find it useful to survey or interview coaches, players, and players' parents to determine their satisfaction with the program's scheduling and conduct of the baseball games and tournaments.

The government or not-for-profit organization should also consider providing a system of tracking service complaints and contractually require the selected provider to resolve each complaint.

DEVELOPING A TRANSITION LOGISTICS PLAN

The transition logistics plan addresses how the service delivery would be actually changed to a new contracted provider. The planning includes identifying any existing capital assets that will be affected, determining if any new capital assets or other purchases are needed, determining any impact from current lease obligations or other contractual requirements, and addressing the direct impact on the service recipients.

Logistics Plan Objectives

The primary objective of the transition logistics plan is to accomplish the service transition with as little disruption as possible in service to the service recipient. The complexity of the target function or activity dictates the level of detail required in the plan.

Five Logistics Issues to Be Addressed

When developing a transition logistics plan, the CPA should address, at a minimum, the following issues.

1. What capital assets (for example, land, buildings, or equipment) will be affected by the transfer? Will they no longer be needed? Be careful when capital assets acquired with federal awards are involved. They may have transfer restrictions placed on them.
2. What new personnel, materials, equipment, and training will be required if a change is made from being the service provider to being a contract monitor?
3. What current contractual or lease obligations must be stopped, bought out, or transferred to the new service provider?
4. How and when will service recipients be notified of the change in providers?
5. How will the service delivery change, if at all? Will service recipients continue to deal directly with the transferring entity or the new service provider?

    Example. A municipality is considering a contract with golf professionals to operate its golf course pro shop. As a result of the consideration of the logistical issues, provisions will be addressed in the RFP for the following:

    - Transfer of title of the pro shop capital assets, including cash registers, computer equipment, sale displays, and furniture
    - Lease arrangements for the pro shop space
    - Valuation and sale of current pro shop inventory to the new provider
    - Percentage of sales to be shared with the municipality
    - Minimum and maximum cost markups and markdowns
    - Entitlement to proceeds from vendor promotions

    The municipality's management also determined that the contract monitoring could be performed with existing employees and equipment, and that no formal public notification of a change in pro shop management was necessary.

A complete and comprehensive transition logistics plan leads to a smoother implementation, when the service is transferred.

DEVELOPING A PERSONNEL PLAN

Government and not-for-profit organization employees may feel uncertain about the introduction of competition into their organizations. Some employees may even resist any change. Labor unions serve as strong voices for the employees when such considerations are undertaken. However, statistics indicate employee displacement has not been the end result of most efforts to compete. The National Commission on Employment Policy, a branch of the U.S. Department of Labor, has published a study titled *The Long-Term Employment Implications of Privatization.* The study reviewed thirty-four privatization programs and their impact on employees. The results were as follows:

- Fifty-eight percent were employed with the new service provider.
- Twenty-four percent were transferred to other positions within the entity.
- Seven percent retired.

- Seven percent were laid off.
- For four percent, the impact was unknown.

It is understandable that the loss of employment is a major concern to employees. How government or not-for-profit organizations plan and prepare for the personnel changes will significantly affect the success of the competition effort. The CPA advising the competition task team should be sure to obtain and understand the government or not-for-profit organization's personnel policies and procedures when addressing personnel change issues.

Personnel Plan Objectives

The personnel plan's primary objective is to accomplish changes in the least disruptive manner for employees. This means making the most appropriate decision for the entity while being as fair as possible to all personnel involved. With careful planning, employee displacement can be minimized or avoided entirely.

Personnel Plan Elements

The following questions should be addressed by the CPA in assisting the competition task team in developing the personnel plan.

- Which employees, if any, will be displaced?
- By what methods or options will each displacement occur?
- Which employees will remain and how will their jobs or responsibilities be affected?
- Which one-time or ongoing personnel costs will be incurred or changed as a result of personnel changes?

Options for Personnel Changes When Required

When changes in personnel are likely to be necessary, the entity has a number of options to consider. The options could include the following:

- *Right of first refusal.* Contracts with a new service provider could include a right-of-first-refusal clause. This clause requires the new provider to offer employment to displaced employees of the transferring entity before going into the open marketplace.
- *Transfer within the entity.* Entities can, when possible, transfer qualified employees to other open positions within the entity.
- *Early retirement.* Entities can implement early retirement programs to be a voluntary incentive program for affected employees.
- *Reduction in work force.* This option should generally be considered the last resort, unless the target function or activity is determined to be overstaffed. In this case, the entity would terminate the employees and eliminate the positions.

> **Example.** A not-for-profit association of licensed building contractors is considering contracting out its accounting function to an outside accounting firm. The external accounting firms that have expressed interest in this contract have each agreed to hire any of the association's four accounting department employees who are CPAs. Only one of the four employees is certified. As a result of completing the personnel plan, the association has determined that, if the activity is contracted out, one of the remaining three employees will be reassigned within the association, while the two

> employees with the least seniority will have their employment terminated. As a result, the association will incur one-time personnel costs from the transition related to the accrued leave and benefits that will be paid to the three employees no longer with the association, that is, the two terminated employees and the CPA hired by the contractor. The association will eliminate all accounting positions.

Any costs associated with the personnel plan, such as payment of accrued compensated absences, post-employment benefits, severance pay, and the like, will need to be included in preparing the cost analysis (see chapter 4).

Addressing Stakeholder Concerns

An important aspect of planning the competition project is anticipating and addressing the concerns of the various stakeholders associated with the target function or activity. The CPA should obtain stakeholders' input and support in the early phases of the project since such input and support is critical to the project's success.

Elected Officials and Board Members

From one perspective, the 1997 GAO Report on Privatization stated that one of the six lessons learned through previous competition efforts it studied was the need for a "political champion" to introduce and sustain the effort. This political champion could be any elected official of a government entity (governor or mayor) or an influential board member of a not-for-profit organization. The report states these officials will be needed to garner public, business, and political support for the competition effort. Ideally, the input and support of the entire elected body or board of directors would be preferable, but this may not be realistic.

However, from another perspective, some past competition projects indicate that it may be better for a government or not-for-profit administrator, rather than a politician or other elected official or appointed board member, to lead the competition effort. This is because administrators are less likely to be politically motivated when it comes to competition efforts or to be unduly influenced by private sector lobbying.

Regardless of who leads the competition effort, the elected officials or board members and administrators should be both knowledgeable of the competition process and informed throughout the process of its progress and decisions. In many situations, these individuals will be involved in or responsible for approving the selected service provider and may also be called upon for needed legislation or administrative policies to facilitate the change.

Employees

Dealing with the employees of the target function or activity can be a delicate matter. While they may initially feel threatened by competition efforts, the project team is likely to increase its ability to garner their support by considering managed competition as an alternative strategy (see chapter 2). If the government or not-for-profit organization selects managed competition, the department performing the target function or activity's service is allowed to compete with outside parties for the service to be provided. Involving the employee representatives of the target function or activity as part of the competition task team can also be instrumental in obtaining and sustaining their support, as well as obtaining their expertise.

Customers, Constituents, Taxpayers, Clients, and Donors

Since these service recipients and interested groups apply pressure to governments and not-for-profit organizations to "provide more with less," such pressure could be a driving force behind the decision to consider introducing competition. However, sometimes these individuals or groups are resistant to changes out of concern over reduced service quality, uncontrollable costs, and an inability to hold the government or not-for-profit organization accountable through the political process. Since it is this group that often needs to be satisfied with the service provided, their involvement and input into the competition process is vitally important. Therefore, representation from this group should be included in the competition task team. In addition, as noted earlier in this chapter, surveys of this group regarding their current level of satisfaction and their interest in a new provider can be useful tools in the planning process.

DETERMINING WHETHER TO CONTINUE

At this point, the competition task team, with the CPA's help, should review the data gathered and plans prepared to date. This review should be focused on making a decision about whether the competition project should continue to the next phase, which includes the development of an RFP and the performance of a cost analysis.

Questions to Ask When Deciding to Proceed

Questions for the competition task team to ask in making the decision about whether to continue include the following.

1. Does the qualitative analysis (see chapter 2) support the decision to introduce competition within the target function or activity?
2. Has the project scope been defined, and are specific deliverables capable of being provided by interested outside contractors?
3. Does the service delivery strategy selected (see chapter 2) meet both the present and future needs of the customer or service recipient?
4. Does the performance monitoring plan indicate that effective performance measuring and monitoring is possible and likely to result in data that will assist in determining cost savings and customer or service recipient satisfaction?
5. Does the transition logistics plan accomplish, in a realistic manner, a smooth transition of service delivery with a minimum of inconvenience to customers or service recipients?
6. Does the personnel plan minimize employee disruption, result in a fair and equitable treatment of employees, and sufficiently identify personnel transition costs?
7. Have stakeholders' concerns been sufficiently addressed and is the project likely to garner their support?

Based upon the answers to these questions, a determination should be made about whether to continue with the competition project.

Example. A planning decision worksheet documents the responses to the questions discussed in this section as they relate to a project to introduce competition into an entity's internal audit function. A sample completed planning decision worksheet indicates the following conclusions were reached at the end of the planning phase (see exhibit 3.1):

- The qualitative analysis indicated the internal audit function was a good candidate for the introduction of competition.
- The specific project scope included a risk-based internal audit plan, and several interested outside firms possessed the necessary qualifications and experience to provide such internal audit services.
- Both present and future needs of the government or not-for-profit organization (the service recipient, in this example) can be met through the transfer of the internal audit function.
- Both quantitative and qualitative performance measures can be developed and monitored over the internal audit activities.
- If the internal audit function is transferred to a new provider, such transfer can be accomplished with a minimum of disruption to current operations.
- The external audit firms all indicated interest in employing certain current employees, thereby minimizing employee disruption.
- The primary stakeholders, including the elected officials or board members, the employees, and the taxpayers, all appear to generally support the consideration of outsourcing the internal audit function.

As a result, the final conclusion is to continue with the project of introducing competition into the internal audit function.

THE CPA'S ROLE IN PLANNING TO INTRODUCE COMPETITION

CPAs and CPA firms can play a significant role in assisting government and not-for-profit organizations plan for competition. The CPA's project management skills and competencies are a valuable asset to the competition task team. The CPA's or CPA firm's role in assisting government and not-for-profit organizations plan for competition can include assistance in the following areas:

- The specific project scope definition
  - —Using the CPA's experience with internal control processes to identify specific activities, policies, and procedures that should be included in the project scope
- The performance measurement plan
  - —Identifying performance measurement indicators for monitoring
  - —Providing benchmarking services for identifying performance standards
  - —Developing financial or compliance monitoring work programs
- The transition logistics plan
  - —Researching and gathering information on capital assets, lease agreements, contractual requirements, and other logistics affected by a transition of service
  - —Calculating the costs associated with a transition

- The personnel plan
  —Identifying personnel affected by a transition and assisting in the consideration of available personnel options
  —Calculating the costs associated with personnel changes
- Stakeholders' concerns
  —Conducting interviews with stakeholders to obtain their input and attempt to garner their support through explaining the competition process and addressing the issues affecting the stakeholders

CONCLUSION

A successful competition project must have early planning and preparation. In general, the tasks at this stage seek to answer the following questions:

- How effectively and efficiently is the government or not-for-profit organization presently delivering the target function or activity's service?
- What specific scope of service will be considered for competition?
- How will the target function or activity's service be transferred to a new provider, if that is the ultimate decision?
- How will the government or not-for-profit organization's employees be affected?
- How will provider performance be monitored?
- Have stakeholder concerns been sufficiently addressed to garner their input and support?

CPAs' skills and competencies are valuable assets to the competition task team in the planning stages of the competition process, and their services can significantly assist government and not-for-profit organizations in making their decision about whether to continue with the project at this point. (See chapter 4, "Cost Analysis: A Step-by-Step Approach," for the next steps: developing an RFP, evaluating proposal responses, and conducting the important cost analysis.)

Exhibit 3.1

Completed Example Planning Decision Worksheet

Target Function: Internal Audit Function **Date:** 10/XX

1. Does the qualitative analysis support the decision to introduce competition into the target function or activity? *Yes. Total weighted score was a positive 6.*
2. Has the project scope been defined and are specific deliverables capable of being provided by interested outside contractors? *Yes. The specific project scope includes a risk-based internal audit plan, and several interested outside firms possess the necessary qualifications and experience to provide such internal audit services.*
3. Does the service delivery strategy selected meet both the present and future needs of the service recipient? *Yes. The board and management are the primary direct recipients of this service. Their needs can be effectively met with a competitive internal audit function.*
4. Does the performance monitoring plan indicate that effective performance measuring and monitoring is capable and likely to result in data that will assist in determining cost savings and customer satisfaction? *Yes. Performance measures, such as the number of recommendations and impact of implementing the recommendations, can be monitored.*
5. Does the transition logistics plan accomplish, in a realistic manner, a smooth transition of service delivery with a minimum of inconvenience to customers? *Yes. No problems are anticipated in transition.*
6. Does the personnel plan minimize employee disruption, result in a fair and equitable treatment of employees, and sufficiently identify personnel transition costs? *Yes. Most outside audit firms have stated they will employ all of our current CPAs and will allow non-CPAs two years to become certified.*
7. Have stakeholders' concerns been sufficiently addressed and will the project likely garner their support? *Yes. The primary stakeholders in this example, including the elected officials or board members, the employees, and the taxpayers, all appear to generally support the consideration of outsourcing the internal audit function.*

Continuation Decision:

Should the competition task team continue with the project of introducing competition into this target function or activity? YES __X__ NO ______

Chapter 4:

Cost Analysis: A Step-by-Step Approach

Cost analysis is a necessary part of the decision-making process regarding the use of competition, whether for a government or a not-for-profit organization. Once a target function or activity has been identified and evaluated and the appropriate competition plans developed, it is time to conduct a cost analysis to determine the cost-effectiveness of a change in service delivery. The elements necessary to calculate and compare include—

1. The relevant costs associated with the performance of the target function or activity by the government or not-for-profit organization.
2. The costs attributed to the target function or activity if it were to be performed by an outside contractor or provider.

The overall purpose of the cost analysis discussed in this chapter is to provide an example mechanism for determining whether cost savings would result from transferring some or all of the target function or activity's services to a new provider. If cost savings will not result, the government or not-for-profit organization may decide to retain the target function or activity with in-house service delivery and consider reengineering the service to become more efficient and effective. This chapter discusses different approaches to gathering applicable costs, how to apply cost accounting techniques for the purpose of comparing in-house and outside provider costs, illustrations of example cost analysis information, and the usefulness of cost analysis forms. This chapter covers the following:

- How to select an approach to determining cost of service
- How to identify and accumulate relevant in-house costs
- How to develop and release a request for proposal (RFP) and evaluate results
- How to identify and accumulate the costs associated with using an outside contractor or provider (outside costs)
- How to compare relevant in-house costs to outside costs

While the cost analysis is an essential part of the competition process, it is not the final step. (See chapter 5, "Provider Selection: How to Make and Implement the Selection Decision," which concludes the process with selecting a provider, developing a contract, and implementing transition and monitoring plans.)

CPAs' accounting and analysis skills and competencies make the cost analysis step of the competition process an area ripe for CPA or CPA firm involvement. Specifically, CPAs can assist in—

- Designing cost accounting systems or methods.
- Developing or reviewing indirect cost allocations.
- Distinguishing between relevant and unavoidable costs.

- Performing the cost analysis and preparing the supporting schedules.
- Comparing in-house and outside provider costs.
- Assisting in making a recommendation for selecting a provider from the cost savings perspective.

CPAs' involvement in the cost analysis part of the competition project is an important consideration for ensuring successful results.

APPROACHES TO DETERMINING COST OF SERVICE

Determining the cost of service related to a target function or activity may not be as easy as it may sound. Many government and not-for-profit organizations, especially smaller ones, may not account for cost of service for each potential target function or activity within their normal accounting system. As a result, only estimated costs may be available. Therefore, professional judgment must be used in the cost accounting analysis.

The Use of Cost Accounting as a Precondition for Decision Making

Cost accounting is a method of accounting that provides for the identification of all elements of costs incurred to accomplish a purpose or function, carry out an activity, or complete a specific job or task. Without such in-house cost information, it is difficult to make an accurate comparison to the proposed cost of an outside contractor performing the function or activity. It is important to understand that the individual performing the cost analysis cannot necessarily rely on the reported amounts for expenditures or expenses of a function or activity within the normal accounting system. This is because those expenditures or expenses may not include all direct costs or allocated indirect costs related to the target function or activity.

Using Activity-Based Costing Methods

Most cost accounting systems track the cost of programs or functions. Few cost accounting systems track the cost of specific activities within a function.

> **Example.** A not-for-profit organization's accounting system may account for the costs of operating its membership services function as a whole; however, the specific costs associated with membership mass mailings may not be available within the normal accounting system. If the government is considering introducing competition into the specific activity of membership mass mailings only, it will be necessary to use judgment to estimate such costs at the membership mass-mailing level.

As this example indicates, professional judgment must often be used to estimate the cost of specific activities when the entire program or function is not targeted for competition.

Ongoing Cost Accounting Systems Versus Periodic Cost Studies

For large government and not-for-profit organizations, cost accounting information may be readily available from ongoing cost accounting systems or analyses. Many state and local governments use internal service funds to record the costs associated with functions or activities that are charged back to other funds' functions or programs. Other governments and not-for-profit organizations record direct costs by function or activity within their normal accounting system and use cost-allocation techniques to perform a formal indirect cost allocation monthly or at year end to capture the total cost of the function or activity.

Example. An Indian tribal government has implemented a comprehensive indirect cost allocation plan in response to its active participation in federal and state award programs. In addition to charging these indirect costs to award programs, the costs are allocated to other tribal functions and activities. The presence of such a plan and its requirements for audit, under U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Not-for-Profit Organizations*, may provide valuable cost of service information by function and activity.

For smaller government and not-for-profit organizations, accurate cost accounting information may be more difficult to obtain. In many of these entities, certain costs associated with operating specific functions or activities may be accounted for in broad functional categories, such as general government or administration. It is unlikely that ongoing systems of cost accounting will be found in these smaller entities. Therefore, cost accounting information must be gathered through periodic cost studies performed when the need arises. This cost information is normally automated with the use of spreadsheet software to facilitate making changes to the data as information is gathered.

Example. A small city, with limited in-house accounting resources, uses a simplified fund accounting system that tracks expenditures by department within a fund. No internal service funds are used to account for and charge out costs that are attributable to the various operating activities of the city. Instead, a general government department within the city's general fund is used to account for costs that benefit but are not charged directly to operating departments and activities. This department reports such costs as general liability and property insurance, certain utilities and communication costs, fleet maintenance costs, and bulk purchases of material and supplies. To arrive at costs of service by function or activity in this example, additional effort will be required to analyze the expenses of the general government department to identify all direct and indirect costs, including some estimation of costs by function and activity.

Cost Categories

There are a number of ways to categorize costs in a cost accounting system, but from the standpoint of competition, the costs should be categorized as follows (see table 4.1).

TABLE 4.1 COST CATEGORIES AND THEIR APPLICATION

Category	Definition	Application Examples
In-house costs	The costs to be incurred by the government or not-for profit organization due to retaining the target function or activity and not privatizing	• Personnel, materials, and supplies, other services and charges, depreciation and other direct costs associated with operating the target function or activity

(continued)

TABLE 4.1 *(continued)*

		• Indirect costs attributable to operating the target function or activity, such as certain insurance, shared utilities, shared maintenance, central information systems costs, and administrative costs
Outside costs	The net costs to be incurred by transferring the target function or activity to a new contractor or provider, including costs associated with contract support and monitoring	• Contract costs proposed by the outside contractors or providers • Contractor support costs, such as target function or activity costs for facilities, equipment, or staff to be lent to outside contractors or providers • Contract monitoring costs to be incurred by the government or not-for-profit organization associated with conducting ongoing performance monitoring of the outside contractors or providers • Loss of revenues, grants, or subsidies resulting from contracting with the outside providers • Outside costs reduced by any new revenue, such as sales tax, rentals, or other fees, resulting from transferring the service to an outside contractor or provider
Direct costs	The costs that can be assigned specifically to the target function or activity	• Personnel costs exclusively benefiting the target function or activity • Other costs exclusively benefiting the target function or activity, such as lease/rental costs, specific capital asset depreciation, materials, supplies, direct repairs and maintenance, certain specific insurance, and directly charged utilities
Indirect costs	The costs necessary for the functioning of the organization as a whole, that benefit the target function or activity, but that cannot be directly assigned to the target function or activity	• Depreciation on shared capital assets, entity-wide insurance, maintenance costs on shared facilities and equipment, utilities, and communication costs on shared facilities

TABLE 4.1 *(continued)*

		• General administrative or internal support services, such as accounting, accounts payable, auditing, budgeting, information system processing, human resources, legal services, mail services, motor pool costs, office space use, payroll, printing services, and procurement
Sunk costs	Costs that have already been incurred that will not be recovered if the target function or activity is transferred to a new contractor or provider (Such costs would not be considered relevant costs.)	• Book value or depreciation of previously acquired capital assets used by the target function or activity
Unavoidable costs	The in-house costs that cannot be avoided if the target function or activity is transferred to a new outside contractor or provider	• All sunk costs and most indirect costs are unavoidable costs • Overhead charges for most administrative costs, such as information system processing, that will still be incurred and charged elsewhere within the entity • Personnel costs that will still be incurred, for example, those costs of target function or activity employees that will be retained
Relevant costs	The costs that can be avoided if a target function or activity is no longer performed in-house; also referred to as avoidable costs	• Most direct costs are relevant costs • Wages and benefits of employees no longer employed • Materials, supplies, and other charges that will no longer be incurred
Full or total costs	The sum of all in-house costs necessary to operate the target function or activity	• All direct and indirect in-house costs to operate the target function or activity

AN INTRODUCTION TO PERFORMING THE COST ANALYSIS

This chapter provides guidance for use in identifying and accumulating in-house costs of the target function or activity and outside costs that would be incurred if a new service provider is selected, and performing a comparison of the relevant in-house costs to the outside provider costs. For the purposes of this chapter, a cost analysis of five time periods is based on fiscal years: the previous fiscal year, the current fiscal year, and the next three projected fiscal years. This assumes a three-year contract period. For shorter or longer contract periods, this cost analysis should be amended to cover the actual contract period. Where possible, longer periods would be preferable for cost analysis purposes in order to fully account for costs or savings associated with long-term assets, such as fixed assets used in the target function or activity. In addition, it is likely that interested service providers will want a contract term that is long enough to amortize the cost of any new equipment acquisitions that may be necessary. Certain considerations are necessary when gathering and projecting this multiple period cost data. These considerations include the following:

- *Previous fiscal year.* The most recent fiscal year or period is desired. However, sound judgment should be used to ensure this period reflects normal costs incurred. If the prior year data includes any material unusual or nonrecurring amounts and is not representative of the normal service cost, a trend analysis should be considered, to include several years or periods.
- *Current fiscal year.* The current full fiscal year's amounts are projected by extrapolating the current year-to-date amounts. Again, care should be taken to exclude any unusual or nonrecurring amounts and include any amounts that are related only to future periods.
- *Projected years.* These costs should reflect the anticipated costs to provide the service in at least the three future periods, including projected cost increases or decreases and service provided at the levels as planned in the performance monitoring plan (see chapter 3).

The cost analysis guidance in the remainder of this chapter is organized into four steps: identify and accumulate relevant in-house costs, manage the request-for-proposal process, identify and accumulate outside costs, and compare relevant in-house costs to outside costs.

Performing a Cost Analysis When Introducing Competition

This section provides an illustrated approach to gathering and analyzing cost data related to introducing competition in a target function or activity, and includes illustrations for gathering and analyzing the cost data in each of the four steps (that follow). Each step in the cost analysis process presented here includes the purpose of performing that step of the analysis, illustrated examples, instructions for preparing and analyzing the cost data gathered, and sample cost analysis forms containing cost information for a typical target function or activity. These illustrations represent one recommended methodology for cost analysis. If a different cost analysis methodology is used, some of the example illustrated forms may not be necessary. For example, more condensed or expanded cost analyses may be considered appropriate even though they result in cost gathering and analyses in a format different from that provided in this publication. Also, some forms may not be necessary, depending on the specific circumstances of the target function or activity. For example, if the target function or activity does not use capital assets in its operation, the example forms for current capital assets and depreciation and revenue generated from asset conversion would not be applicable. The CPA's professional judgment should be applied in determining the appropriateness of the cost analysis forms provided in this publication.

Step 1: Identify and Accumulate Relevant In-House Costs

The purpose of this step in the cost analysis is to assemble and accumulate the costs to be incurred by the government or not-for-profit organization operating the target function or activity as defined in the project scope. This cost is based on retaining the service delivery in-house at a level necessary to meet the desired performance measures as previously planned (see chapter 3). These should be the same performance measures requested of outside contractors or providers in the RFP to facilitate a fair comparison. Any costs associated with changes needed or proposed to the current method of in-house service delivery should be included in the analysis.

Determining Relevant Versus Unavoidable In-House Costs

In conjunction with the competition process, in-house costs will be addressed from the standpoint of "relevant" (avoidable) and "unavoidable" costs (see cost category definitions in table 4.1). When determining the in-house cost of service, all costs should be accumulated, including direct payroll and benefit costs, direct materials, supplies and other charges, allocated overhead costs, and cost of capital assets. While all costs are accumulated and considered, the only costs that should be used in a comparison to outside costs of a proposing contractor or provider are relevant (avoidable) costs—that is, only the amount of money that will actually be saved if the service is contracted out.

The cost analysis illustrated in this chapter requires the initial determination of total in-house costs (the sum of relevant and unavoidable costs, including direct and indirect). Once the total costs for the target function or activity are determined, relevant costs must be identified. So that the true potential cost savings to the government or not-for-profit organization is known, relevant costs form the basis of comparison to the outside contractor or provider costs (see step 4 of the cost analysis).

The primary purpose of identifying and accumulating total in-house costs related to providing the target function or activity's service is to compare the relevant in-house costs to the outside costs of a proposing contractor. However, determining total in-house costs is useful for other purposes, such as service charge rate setting. For example, accumulating the total in-house costs associated with a not-for-profit organization's family counseling service will be useful in establishing the billing rates for such services regardless of the end result of the competition process. For this reason, total in-house costs, both relevant and unavoidable costs, are identified and accumulated in this analysis.

Determining Relevant Direct Costs of the Target Function or Activity

As previously defined, direct costs are the costs specifically identified with operating the target function or activity and are incurred for the sole benefit of that service. Most direct costs are also considered relevant costs. These costs include any number of categories, including personnel costs exclusively benefiting the target function or activity; materials and supplies; lease and rental costs; equipment and capital costs for assets used solely in the target function or activity; repairs and maintenance; travel and training; and directly charged insurance, telecommunications, and utilities costs. In certain accounting systems some of these costs may be allocated as indirect costs. For example, such costs as insurance, telecommunications, utilities, and some depreciation may be allocated to a target function or activity rather than charged directly because the charges or costs incurred are not specific to the target function or activity or are not identified separately.

Illustrations for Identifying and Accumulating Relevant Direct In-House Costs

The relevant direct cost information accumulated in the following illustrated examples is used in step 4 of the cost analysis to prepare a summary schedule comparing in-house relevant costs to outside contractor or provider costs (see illustration 4.15, "Schedule A: Summary of Relevant Costs"). In identifying and accumulating relevant direct in-house costs, the following illustrated example cost analysis forms are provided:

- Illustration 4.1, "Schedule B: Summary of Relevant Direct Costs"
- Illustration 4.2, "Schedule C: Personnel Costs"
- Illustration 4.3, "Schedule D: New Capital Assets and Depreciation Costs"
- Illustration 4.4, "Schedule E: Depreciation Cost for Current Capital Assets"
- Illustration 4.5, "Schedule F: Lease/Rental Costs"
- Illustration 4.6, "Schedule G: Other Direct Costs"

Illustration 4.1

Schedule B: Summary of Relevant Direct Costs

Purpose. Use the summary of relevant direct costs to accumulate relevant direct costs of the target function or activity (those that can be avoided if the target function or activity is no longer performed in-house). These costs are compared to total outside contractor or provider costs when determining which provider is the most cost-effective.

Instructions. Schedule B is completed using the information calculated on the supporting direct costs Schedules C through G (see illustrations 4.2 through 4.6); therefore, Schedules C through G, to the extent applicable, must be completed before the preparation of Schedule B. This Schedule B summary information is ultimately carried forward to Schedule A, the Summary of Relevant Costs (see illustration 4.15), Line A, to complete the cost analysis.

Example. The example (see the completed form, opposite) indicates a total of relevant direct costs of the example target activity of $509,000 for the prior year (historical), $530,000 for the current year, and a projection of $1,768,050 for the three-year contract period, the sum of relevant direct costs for contract periods one through three on the schedule. All of the historical, current year, and contract period costs summarized in this illustration are costs that have been identified, accumulated, and determined to be relevant from other supporting cost analysis schedules (Schedules C through G, illustrations 4.2 through 4.6). The cost categories summarized in this illustration should be tailored to meet the specific cost categories applicable to the target function or activity. For example, in this illustration, there are no relevant direct costs related to depreciation of old capitalized equipment. However, depreciation of new capital assets is a relevant cost, as this cost would be avoided if service were retained in-house. Further additional cost categories may be needed depending on the target function or activity.

Illustration 4.1 *(continued)*

Schedule B: Summary of Relevant Direct Costs*
Completed Form

AGENCY: Example Entity   TARGET ACTIVITY: Example Activity

	Review Periods' Relevant Costs (a)					
Cost Category	A Historical Year	B Current Year	C Contract Period 1	D Contract Period 2	E Contract Period 3	F Contract Total (b)
A. Personnel (Schedule C)	$290,000	$300,000	$315,000	$330,750	$347,300	$ 993,050
B. New capital assets (Schedule D)	0	0	1,000	0	0	1,000
C. Depreciation – new capitalized assets (Schedule D)	0	0	3,000	3,000	3,000	9,000
D. Lease/rental (Schedule F)	36,000	38,000	40,000	42,000	44,000	126,000
E. Other direct costs (Schedule G)	183,000	192,000	202,000	213,000	224,000	639,000
Total (c)	$509,000	$530,000	$561,000	$588,750	$618,300	$1,768,050

Footnotes:

(a) This schedule includes only "relevant" direct costs of the target activity. (See table 4.1 for definitions of both relevant and direct costs.)
(b) Total relevant direct costs for the proposed contract period, the sum of columns C, D and E. In this example, contract period is three years.
(c) Represents total relevant direct costs of the target activity for each review period. Enter on Schedule A, Line A (illustration 4.15).

* Source: Adapted from the State of Arizona *Competitive Government Program Handbook*, July 2000, Governor's Office of Excellence in Government. This form is included for your convenience and information only. Periodically, the state updates or changes the forms that were adapted for this publication. You should check the Arizona Web site (www.governor.state.az.us/excellence) if you have an interest in any updates that the state may have made to the forms since this publication was issued.

Illustration 4.2

Schedule C: Personnel Costs

Purpose. Use the personnel costs worksheet to identify and accumulate the relevant direct personnel costs specific to the target function or activity. These costs are one of the components of the costs gathered for determining total relevant direct costs of the target function or activity.

Instructions. Each position and its number of full-time equivalents (FTEs) employed directly in the target function or activity should be listed (in part 1 of the worksheet), and total current gross pay and fringe benefits should be calculated. Once these costs have been totaled, any unavoidable personnel costs should be subtracted from the total costs to arrive at total relevant personnel costs. Obtain the total relevant direct personnel costs for the prior year and enter the total in the Historical Year column of part 2 of the worksheet. Enter the total relevant direct personnel costs as calculated in part 1 of the worksheet in the Current Year column of part 2. Project any estimated increases or decreases in relevant direct personnel costs over the contract period and enter the amounts in the appropriate Contract Period columns in part 2. The total relevant direct personnel costs for all presented periods in part 2 of the worksheet are carried forward to Schedule B, Summary of Relevant Direct Costs (see illustration 4.1), Line A.

Example. The example (see the completed form, opposite) reflects total personnel costs directly attributable to the example target activity of $300,000 for the current year, and the entire amount is considered relevant direct costs. This indicates that all eleven employees included in this example will no longer be employed in this activity if it is performed by an outside contractor or provider. As a result, there are no unavoidable direct personnel costs in this example and all costs are considered relevant. If certain positions were retained, transferred within the entity, or otherwise not eliminated by the entity, such personnel and their related costs would be included in this analysis but would normally be included in the subtotal for unavoidable costs (see footnote b in the completed form, opposite) and thereby subtracted from total costs to calculate the relevant direct personnel costs. However, if a transferred employee replaces a retiring employee in another activity, the employee's personnel costs would be considered relevant or avoidable as long as there is a net organization-wide reduction in employees. Once the current year personnel costs have been calculated, the relevant personnel costs anticipated for the contract period are estimated by increasing or decreasing the current year relevant amount by projected personnel cost changes over the contract period. In this illustrated example, it is assumed that the relevant and direct current year personnel costs will increase by approximately 5 percent per year, for a total of $993,050 over the three-year contract period.

Illustration 4.2 *(continued)*

Schedule C: Personnel Costs*
Completed Form

AGENCY: Example Entity TARGET ACTIVITY: Example Activity

Part 1: Current Year Relevant Costs

A Position Title	B Number of Full-time Equivalent Positions	C Average Annual Salary/Wage	D Total Annual Salary/Wage (B x C)	E Fringe Benefits (D x 0.20)	F Total Personnel Costs (D + E)
Department head	1	$42,000	$ 42,000	$ 8,400	$ 54,000
Class II workers	10	$20,800	$208,000	$41,600	$249,600
			Total direct personnel costs		$300,000
			Less: Unavoidable costs (a)		$ 0
			Total relevant costs (b)		$300,000

Part 2: Review Period Relevant Costs (c)

Historical Year (d)	Current Year (e)	Contract Period 1 (f)	Contract Period 2 (f)	Contract Period 3 (f)	Contract Periods Total (g)
$290,000	$300,000	$315,000	$330,750	$347,300	$993,050

Footnotes:

(a) Unavoidable costs, as defined in table 4.1, are subtracted from the total direct personnel costs to determine relevant costs. In this example, all employee positions of the target activity will be eliminated if the activity is contracted out. Therefore, there are no unavoidable direct personnel costs.

(b) Relevant costs, as defined in table 4.1, are avoidable costs. In this example, all direct personnel costs are avoidable if the activity is contracted out, since no employee positions will remain in the target activity.

(c) The review period relevant costs in part 2 will be carried forward to Schedule B, Line A (see illustration 4.1).

(d) Relevant direct personnel costs of the target activity were obtained from prior year accounting records.

(e) Current year relevant direct personnel costs as calculated in part 1 above.

(f) Contract period costs are calculated, in this example, as a 5 percent increase each year from the previous period or year.

(g) Total for the proposed contract period which equals the sum of contract periods 1, 2 and 3. In this example, the contract period is three years.

* Source: Adapted from the State of Arizona *Competitive Government Program Handbook*, July 2000, Governor's Office of Excellence in Government. This form is included for your convenience and information only. Periodically, the state updates or changes the forms that were adapted for this publication. You should check the Arizona Web site (www.governor.state.az.us/excellence) if you have an interest in any updates that the state may have made to the forms since this publication was issued.

Illustration 4.3

Schedule D: New Capital Assets and Depreciation Costs

Purpose. Use the new capital assets and depreciation costs worksheet to accumulate and calculate the costs for any new equipment or other capital assets needed by the entity to continue to provide the target function or activity service. These costs can be identified in the transfer logistics plan and will be included in total relevant direct costs.

Instructions. Through a review of the transfer logistics plan, identify any new capital assets the target function or activity will require over the contract term. Enter the projected costs for nondepreciable assets on Schedule D, column B, and projected costs for depreciable assets on Schedule D, column C. Calculate the sum of the projected costs for all new capital assets not capitalized and carry the total to Schedule B, Summary of Relevant Direct Costs (see illustration 4.1), Line B, in the column for the contract period that the asset will be acquired. Calculate the annual depreciation for capitalized and depreciable new capital assets and carry the total from Schedule D, column G, to Schedule B, Line C. For any new capital assets acquired whose useful life extends well beyond the contract term (for example, a new building with a thirty-year useful life required under a five-year contract), the entire cost of acquiring such capital assets should be treated similar to fixed assets not capitalized, as defined above. This acquisition cost is reflected as a relevant cost in the period acquired since the majority of its depreciation cost will not be recognized during the contract period.

Example. The example (see the completed form, opposite) reflects a total one-time projected cost of new nondepreciable equipment of $1,000 and annual depreciation cost for new capitalized equipment of $3,000. This indicates that the target activity will need to acquire a new inspector's vehicle and electronic equipment in the first year of the contract. Generally, the specifics of the entity's capitalization policy will determine whether the cost is included as one-time new capital asset cost or is capitalized and depreciated over its useful life. For example, if the entity's policy is to capitalize fixed assets valued in excess of $2,000, the new electronic equipment that costs $1,000 will be included in the cost analysis as a relevant one-time cost, while the new inspector's vehicle costing $16,000 will be capitalized and depreciated, net of estimated salvage value over its five-year useful life, at a rate of $3,000 per year. This cost analysis schedule will not be applicable if the target function or activity will not require any new equipment or other capital assets over the proposed contract term.

Illustration 4.3 *(continued)*

Schedule D: New Capital Assets and Depreciation Costs* Completed Form

AGENCY: Example Entity TARGET ACTIVITY: Example Activity

A Description of Asset Item	B Projected Cost for Nondepreciable Assets (a)	C Projected Cost for Depreciable Assets (b)	D Estimated Salvage Value	E Depreciation Base (C–D)	F Useful Life	G Annual Depreciation Costs for Depreciable Assets (b) (E / F)
New inspector's vehicle		$16,000	$1,000	$15,000	5 years	$3,000
Electronic equipment	$1,000					$ 0
Relevant totals (c)	$1,000					$3,000

Footnotes:

(a) In this example, the target activity's policy is to capitalize fixed assets whose purchase cost exceeds $2,000. Because the electronic equipment's full purchase cost of $1,000 is less than the capitalization policy amount, it is a nondepreciable asset and, therefore, it is considered a relevant direct cost.

(b) In this example, the purchase cost of the new inspector's vehicle of $16,000 exceeds the capitalization policy amount of $2,000. In addition, the five-year useful life is within a reasonable range of the contract period. As a result, the purchase cost, less salvage value, of the vehicle is depreciated over its useful life at $3,000 per year.

(c) The relevant total in column B is included in Schedule B, Line B, in the first contract period. The relevant total in column G is included in Schedule B, Line C, for each contract period. (See illustration 4.1 for Schedule B.)

* Source: Adapted from the State of Arizona *Competitive Government Program Handbook*, July 2000, Governor's Office of Excellence in Government. This form is included for your convenience and information only. Periodically, the state updates or changes the forms that were adapted for this publication. You should check the Arizona Web site (www.governor.state.az.us/excellence) if you have an interest in any updates that the state may have made to the forms since this publication was issued.

Illustration 4.4

Schedule E: Depreciation Cost for Current Capital Assets

Purpose. This publication includes the calculation of depreciation on current capital assets used by the target function or activity because, although not used as a relevant cost in the competition project cost analysis, it is important for determining total or full in-house costs for rate setting or other cost accounting purposes. Use the depreciation cost for current capital assets worksheet to calculate the total annual depreciation cost for current capital assets specifically used to provide the target function or activity's service for inclusion in total direct costs. Although calculated for full cost accounting purposes, these depreciation costs are not relevant costs since the assets were acquired in previous periods and will either continue to be used and depreciated or will be sold or otherwise disposed of. The book value and any related depreciation charges on these existing capital assets are considered sunk costs. However, any proceeds received from the sale or disposal of these assets will be considered a reduction to relevant costs.

Instructions. Identify any current capitalized assets the target activity uses to provide its service. Enter the assets' cost, including capitalized improvements, less any salvage value, on the worksheet as the depreciation base on Schedule E, column E. Calculate the annual depreciation for all capitalized and depreciable assets by dividing the depreciation base by the estimated useful life for each asset. The total annual depreciation is then calculated. The total depreciation cost is then included as a sunk cost on the schedule and deducted from the total to reflect no relevant depreciation costs. If any proceeds are to be received from the sale or other disposal of existing capital assets, the net proceeds are to be recorded in Schedule M, Revenue Generated From Asset Conversions.

Example. The example (see the completed form, opposite) indicates a total of annual depreciation costs of the example target activity's current capital assets of $30,000, all of which is not considered relevant. In this illustration, it is assumed all the listed assets will be sold to the outside contractor or provider. The proceeds from the sale of these assets are considered relevant and are included in Schedule M, Revenue Generated From Asset Conversions as a reduction of relevant costs (see illustration 4.12).

Illustration 4.4 *(continued)*

Schedule E: Depreciation Cost for Current Capital Assets*
Completed Form

AGENCY: Example Entity TARGET ACTIVITY: Example Activity

Purchase Date	A Description of Asset Item	B Purchase Price	C Improvements Capitalized	D Salvage Value	E Depreciation Base (B + C) – D	F Useful Life	G If Not Fully Depreciated Annual Depreciation Cost (E / F)
xx-xx-xx	Five trucks (a)	$110,000	$0	$10,000	$100,000	5 years	$20,000
xx-xx-xx	Mowing equipment (a)	$ 50,000	$0	$ 0	$ 50,000	5 years	$10,000
				Total costs			$ 30,000
				Less: Unavoidable sunk costs (a)			(30,000)
				Relevant costs (b)			$ 0

Footnotes:

(a) In this example, all five trucks and the mowing equipment (all capital assets used by the target activity) will be sold to the outside contractor. The annual depreciation costs for these assets are considered a sunk and unavoidable cost.

(b) Under the approach used in this publication, depreciation costs on all current capital assets, regardless of disposition, are not considered relevant. Although not resulting in any relevant costs, this form is completed for the purpose of gathering total costs of operation for the target function or activity.

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Illustration 4.5

Schedule F: Lease/Rental Costs

Purpose. Use the lease/rental costs worksheet to identify and accumulate the total and relevant costs for any leased equipment or buildings used by the target function or activity in providing its service for inclusion in total relevant direct costs.

Instructions. Identify all leased assets used by the target function or activity in providing its service and determine the related annual costs for the prior year, current year, and each year of the contract period. Once these leases and rental contracts have been identified, their annual costs are included in Schedule F in the total columns for each applicable period. Contract period lease costs for future years are projected based on contractual increases or decreases, if any, or historical trends. Any unavoidable lease or rental costs should be subtracted from the total costs to arrive at relevant lease/rental costs that are recorded in the relevant cost column for each period. Unavoidable costs would be related to lease or rental costs that would continue even if the entity no longer delivered the service. The relevant annual lease/rental cost is carried forward to Schedule B, Summary of Relevant Direct Costs (illustration 4.1), Line D.

Example. The example (see the completed form, opposite) indicates total annual lease/rental costs of the example target activity of $48,000 for the prior year (historical); $51,000 for the current year; and a projection (using an approximate 5 percent annual increase) of $54,000, $57,000, and $60,000 over the three-year contract period. All of the historical, current year, and contract period costs summarized in this illustration are costs that have been identified, accumulated, and determined to be specifically applicable to operating the example target activity. Once total direct lease rental costs have been accumulated, any unavoidable costs should be subtracted from the total for each period to arrive at relevant lease/rental costs. In this example, computer equipment used in the target activity will be retained and used in contract monitoring; therefore, it is excluded from relevant costs. The other machinery/equipment leases will be terminated if the target activity is transferred to an outside provider; therefore, these costs are avoidable and included in relevant costs.

Illustration 4.5 *(continued)*

Schedule F: Lease/Rental Costs*
Completed Form

AGENCY: Example Entity   TARGET ACTIVITY: Example Activity

Cost Category	Historical Year		Current Year		Contract Period 1		Contract Period 2		Contract Period 3	
	Total Cost	Relevant Cost	Total Cost	Relevant Cost	Total Cost	Relevant Cost	Total Cost	Relevant Cost	Total Cost	Relevant Cost
Land										
Buildings										
Computer equipment (a)	$12,000	$ 0	$13,000	$ 0	$14,000	$ 0	$15,000	$ 0	$16,000	$ 0
Vehicles										
Other machinery/ equipment (b)	$36,000	$36,000	$38,000	$38,000	$40,000	$40,000	$42,000	$42,000	$44,000	$44,000
Total (c)	$48,000	$36,000	$51,000	$38,000	$54,000	$40,000	$57,000	$42,000	$60,000	$44,000

(Review Periods)

Footnotes:

(a) Computer equipment will be retained and used. Therefore, because it is an unavoidable cost, it is not included as a relevant cost.

(b) Other machinery and equipment will no longer be retained and used by the entity. Therefore, because its lease/rental costs will be avoidable, it is considered a relevant cost.

(c) Enter totals of relevant costs columns in the appropriate periods on Schedule B, Line D (see illustration 4.1).

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Illustration 4.6

Schedule G: Other Direct Costs

Purpose. Use the other direct costs worksheet to identify and accumulate the total and relevant annual costs for the remaining direct cost categories, such as materials and supplies, repairs, and maintenance, that are specifically applicable to operating the target function or activity service. These relevant costs are then included in total relevant direct costs.

Instructions. Identify and accumulate the remaining total other direct costs applicable to the target function or activity. Once these costs have been accumulated, they are recorded in Schedule G for each applicable period in the total cost column. Any unavoidable costs should be subtracted from the total costs to arrive at total relevant costs recorded in the relevant cost column for each period. Unavoidable costs would be related to costs that would continue even if the entity no longer provided the service, such as utility costs for retained facilities that will still have to be paid even though the activity's service is no longer provided. The total relevant other direct costs are carried forward to Schedule B, Summary of Relevant Direct Costs (illustration 4.1), Line E.

Example. The example (see the completed form, opposite) indicates total annual other direct costs of the example target activity of $200,000 for the prior year (historical); $210,000 for the current year; and a projection (using a 5 percent estimated annual cost increase) of $221,000, $233,000 and $245,000 over the three-year contract period. All of the historical, current year, and contract period costs summarized in this illustration are costs that have been identified, accumulated, and determined to be specifically applicable to operating the example target activity. In this example, the utilities and other costs are considered unavoidable and are therefore not included in the relevant cost column. The insurance, materials and supplies, repairs and maintenance, and telecommunications direct costs are included in the relevant cost column since they will be avoided, in this example, through transferring the target activity to an outside provider.

Illustration 4.6 *(continued)*

Schedule G: Other Direct Costs*
Completed Form

AGENCY: Example Entity TARGET ACTIVITY: Example Activity

Cost Category	Review Periods									
	Historical Year		Current Year		Contract Period 1 (a)		Contract Period 2 (a)		Contract Period 3 (a)	
	Total Cost	Relevant Cost	Total Cost	Relevant Cost	Total Cost	Relevant Cost	Total Cost	Relevant Cost	Total Cost	Relevant Cost
Insurance (b)	$ 20,000	$ 20,000	$ 21,000	$ 21,000	$ 22,000	$ 22,000	$ 23,000	$ 23,000	$ 24,000	$ 24,000
Materials & Supplies (b)	120,000	120,000	126,000	126,000	132,000	132,000	139,000	139,000	146,000	146,000
Repairs & Maintenance (b)	40,000	40,000	42,000	42,000	44,000	44,000	46,000	46,000	48,000	48,000
Telecommunications (b)	2,000	2,000	2,000	2,000	2,500	2,500	3,000	3,000	3,500	3,500
Travel (b)	1,000	1,000	1,000	1,000	1,500	1,500	2,000	2,000	2,500	2,500
Utilities (c)	16,000	0	17,000	0	18,000	0	19,000	0	20,000	0
Other (c)	1,000	0	1,000	0	1,000	0	1,000	0	1,000	0
Total (d)	$200,000	$183,000	$210,000	$192,000	$221,000	$202,000	$233,000	$213,000	$245,000	$224,000

Footnotes:
(a) Assumes a 5 percent annual cost increase for certain cost categories.
(b) These costs are considered avoidable since they will no longer be incurred if the target activity service is no longer provided. As a result, they are included in the relevant cost column.
(c) These costs are considered unavoidable because the utility and other costs will still be incurred even after the target activity service is no longer provided. As a result, they are considered unavoidable and not included in the relevant cost column.
(d) Enter relevant costs column totals in the appropriate period on Schedule B, Line E (see illustration 4.1).

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Determining Relevant Indirect Costs That Should Be Allocated to the Target Function or Activity

As previously defined, indirect costs are costs incurred by the government or not-for-profit organization that benefit more than one function or activity, including the target function or activity. These indirect costs can be classified as either target function or activity-specific indirect costs, or entity-wide indirect costs.

> **Example.** If the target function or activity is a specific service of a larger function (for example, a water-treatment activity of the water-delivery function), the indirect costs within the water delivery function (for example, the water-delivery function administrative costs) may need to be allocated to the water treatment specific activity. The water delivery function itself may also be allocated entity-wide indirect costs, such as central personnel administrative costs of the government as a whole. A portion of this entity-wide indirect cost may also be allocated to the specific activity.

Depending on the level of sophistication of the accounting system of the government or not-for-profit organization, the accumulation or calculation of indirect costs may require more or less effort. If the target function or activity is routinely allocated indirect costs through a formal cost allocation system or plan, the cost information will be readily available. However, when such a cost-allocation is not routinely performed, the calculations must be performed as part of the cost analysis. The key to an equitable cost allocation plan is an appropriate allocation base.

Indirect costs can be allocated on a total basis or by specific service type (see exhibit 4.1 for suggested allocation bases). An example of each follows.

> **Example.** For total basis allocation, legal department costs could be allocated to the target function or activity based on the number of employees or FTEs within the target function or activity, divided by the total number of employees or FTEs served by the legal department.

Total legal department indirect costs to be allocated	\$2,000,000
Total number of FTEs of the entity	1,000
Target function or activity's number of FTEs	100
Percent of indirect costs to be allocated to target function or activity	(100/1,000) = 10%
Allocated indirect costs	(\$2,000,000 x .10) = \$200,000

Example. For specific service type allocation, an equitable charge for accounts payable processing costs may be on the basis of the number of transactions processed for the target function or activity, divided by the total number of transactions processed by the accounts payable function.

Total accounts payable processing indirect costs to be allocated	$200,000
Total number of accounts payable transactions	20,000
Target function or activity's number of accounts payable transactions	1,000
Percent of indirect costs to be allocated to target function or activity	(1,000/20,000) = 5%
Allocated indirect costs	($200,000 x .05) = $10,000

For the purpose of identifying and accumulating indirect in-house costs, the following illustrated example is provided.

- Illustration 4.7: "Schedule H: Summary of Relevant Indirect Costs"

Illustration 4.7

Schedule H: Summary of Relevant Indirect Costs

Purpose. Use the summary of relevant indirect costs to identify, accumulate, or calculate the cost information related to the total and relevant indirect costs applicable to operating the target function or activity. Any relevant indirect costs will be included in total relevant in-house costs (see Schedule A, illustration 4.15) for comparison to total outside contractor or provider costs.

Instructions. If the entity uses a total basis method for cost allocation, the worksheet will have only one line completed for each of the applicable years since indirect costs are not allocated by type of service. For those entities using a specific service type method of cost allocation, one line of the worksheet should be completed for each specific allocated cost. Once these costs have been accumulated, any unavoidable indirect costs should be subtracted from the total indirect costs to arrive at total relevant indirect costs. Unavoidable costs are costs that would continue even if the entity no longer provided the service, such as indirect administrative costs. Normally, most indirect costs are considered unavoidable since they will likely continue to be incurred even if the target activity is contracted out. Care should be exercised in determining the amount of allocated indirect costs that are relevant or avoidable. For example, electric power costs are normally billed on a step basis (different rates for different levels of service), while it may be allocated to a specific activity on an average cost basis. The relevant costs are the actual costs that would be avoided if the target activity were transferred, not necessarily the amount allocated as indirect costs. Any total relevant indirect costs are carried forward to Schedule A, the Summary of Relevant Costs (illustration 4.15), Line B.

Example. The example (see the completed form, opposite) indicates total annual indirect costs allocated to the example target activity of $100,000 for the prior year (historical); $105,300 for the current year; and a projection (using a 5 percent estimated annual cost increase) of $110,600, $115,900 and $121,700 over the three-year contract period. All of the historical, current year and contract period costs summarized in this illustration are costs that have been determined to benefit the example target activity but are not charged directly to it. As discussed previously, any indirect costs applicable to operating the target function or activity can be allocated on either a total basis or specific service basis. The example in illustration 4.7 allocates three specific service type indirect costs. In this example, the indirect information systems costs and administrative costs allocated are considered unavoidable and are therefore not included in the relevant cost column since, in this example, they will still be incurred if the target activity is transferred to an outside provider. However, the vehicle maintenance indirect costs are considered relevant since, in this example, it is assumed all vehicles used in the target activity will be sold or otherwise disposed of and further maintenance costs incurred.

Illustration 4.7 *(continued)*

Schedule H: Summary of Relevant Indirect Costs*
Completed Form

AGENCY: Example Entity TARGET ACTIVITY: Example Activity

	Review Periods									
Indirect Cost Category	Historical Year		Current Year		Contract Period 1 (a)		Contract Period 2 (a)		Contract Period 3 (a)	
	Total Cost	Relevant Cost	Total Cost	Relevant Cost	Total Cost	Relevant Cost	Total Cost	Relevant Cost	Total Cost	Relevant Cost
Vehicle maintenance (b)	$ 25,000	$25,000	$ 27,000	$27,000	$ 28,000	$28,000	$ 29,000	$29,000	$ 30,500	$30,500
Information systems (c)	$ 5,000	$ 0	$ 5,300	$ 0	$ 5,600	$ 0	$ 5,900	$ 0	$ 6,200	$ 0
Other administrative costs (c)	$ 70,000	$ 0	$ 73,000	$ 0	$ 77,000	$ 0	$ 81,000	$ 0	$ 85,000	$ 0
Total (d)	$100,000	$25,000	$105,300	$27,000	$110,600	$28,000	$115,900	$29,000	$121,700	$30,500

Footnotes:

(a) Assumes a 5 percent annual cost increase.

(b) The vehicle maintenance indirect costs will no longer be incurred with the disposal of the vehicles used in the target activity. Therefore, the costs are considered avoidable and included in the relevant cost column.

(c) Assumes information systems and administrative costs are unavoidable indirect costs since they will still be incurred even though the target activity's service is no longer provided in-house.

(d) Enter totals from the relevant cost columns in the appropriate periods on Schedule A, Line B (see illustration 4.15).

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Step 2: Manage the Request-for-Proposal Process

The information gathered in the planning and preparation stages of the project (see chapter 3) will now be used to prepare and issue a Request for Proposal (RFP) to qualified and interested service providers.

RFP Contents

The release of the RFP represents the seriousness of the government or not-for-profit organization in proceeding with the competition effort. The RFP must incorporate the issues addressed in the planning phase including the transition logistics plan, personnel plan, and performance monitoring plan. For example, the RFP should include service delivery requirements that the service contractor or provider meet the desired performance measures established in the performance monitoring plan. The RFP should address the consequences of exceeding or failing to meet the desired performance standards.

> **Example.** An RFP to contract out a state agency's welfare-to-work program could provide for contractor or provider incentives in the form of bonuses depending on the amount of wages former welfare recipients are paid, or penalties in the form of reduced provider compensation if the wages paid to former welfare recipients do not meet expectations.

It is important to note that the RFP scope of work must be the same as used in determining in-house costs in order for a fair comparison to be made of the costs (see exhibit 4.2 for an example RFP for the outsourcing of a city government's information technology function).

Compliance With Legal Requirements and Entity Policies

The exact format of the RFP and its issuance and evaluation procedures will normally be dictated by legal competitive bidding requirements or procurement policy. For government entities, legal requirements often determine the process to follow and any contractual constraints. For government and not-for-profit organizations, a thorough understanding of the procurement, contracting, and competitive bidding requirements and policies applicable to the entity is necessary to ensure compliance in preparing the RFP. In addition, in a managed competition process, where in-house agencies or departments compete with the outside contractors or providers, it is important for the RFP or bid specifications to be developed or reviewed by an office or individual independent of the in-house competing agency or department. The procurement office of the issuing entity should be maximized in the development of the RFP and evaluation of its responses.

Ideally the RFP and resulting contract should cover at least a three-year period, if within legal capabilities. Such a multiyear period provides for—

- *Performance measurement validation.* With at least a three-year contract period, sufficient time is available to validate the adequacy of actual performance, as well as the performance measures used.
- *Maintaining the competitive objective.* By re-bidding the target function or activity every three years, the entity can remain current with private sector pricing, service delivery methods, and performance measures.
- *Attracting provider interest.* Since the start-up costs may be prohibitive for a short-term contract, a longer contract period will attract more contractor or provider interest and likely improve total contract costs.

Certain governments may be restricted by law to only single-year contracts or requirements that subsequent year commitments be subject to annual appropriations (however, this is most likely not applicable to not-for-profit organizations). If so, the government should consider including an appropriation clause in multiple-year contracts. Such a clause would require the governing body to appropriate funding for the contract to be renewed annually. Potential contractors or providers should be made aware of this provision in the RFP.

Evaluating the Proposals

The processing of proposals received in response to the RFP will be guided by the applicable legal requirements and procurement policies of the soliciting entity. This evaluation will normally be performed by the procurement office of the entity. However, the competition task team or its representative should oversee the proposal evaluation process. The responses to the RFP should be evaluated for the following criteria:

- Experience, longevity, and reputation in providing the target service and comments from references
- Concurrence with performance measures and standards outlined in the performance monitoring plan and agreement with proposed corrective action or penalties for complaints or failures to meet standards
- Willingness and ability to meet the demands of the transition logistics plan and to meet the objective of minimizing service disruption
- Willingness and ability to implement the objectives of the personnel plan regarding employee impact
- Costs proposed over the contract term

The competition task team will review the evaluation of the responses to the RFP and will make a recommendation about how to proceed. The recommendation could be to reject all outside proposals and retain the target function or activity in-house, or could involve a recommendation to continue with the cost analysis using the outside offer most advantageous to the entity. It may be desirable for the competition task team to develop the Outside Costs section of the cost analysis for each bid received as part of making the decision on recommending an offer from potential outside providers.

In a managed competition strategy, the in-house agency or department proposal response or bid should be sealed, submitted, and evaluated in the same manner as those of the outside contractors or providers to reinforce the fairness of the competition.

Once the proposals have been evaluated and the competition task team has made a recommendation, the procurement office may then pursue negotiations with the most responsive providers. In managed competition, if the recommendation is to award the bid to the in-house agency or department, steps 3 and 4 of the cost analysis will not be performed. If the recommendation is to consider the offer of an outside contractor or provider, the cost analysis should continue with step 3 (identifying and accumulating outside costs) and step 4 (comparing relevant in-house costs to outside costs).

Once the offer has been negotiated with the potential contractor or provider, a competition task team representative should develop the outside costs section of the cost analysis, unless this was already done as part of the competition task team's decision-making process in recommending an offer from an outside provider.

Step 3: Identify and Accumulate Outside Costs

The purpose of identifying and accumulating outside costs is ultimately to make a decision about the cost-effectiveness of performing the target function or activity through a new outside contractor or provider versus retaining the service in-house. This task will involve the accumulation of all the net costs attributed to contracting with the outside contractor or provider, including outside contractor or provider charges, and costs of transition, monitoring, and personnel displacement. These outside costs are then reduced by any new revenue and/or proceeds from asset sales or conversions resulting from the transition to the outside contractor or provider.

Illustrations for Identifying and Accumulating Outside Costs

In identifying and accumulating outside costs, the following illustrated example cost analysis forms are provided:

- Illustration 4.8, "Schedule I: Contractor Costs"
- Illustration 4.9, "Schedule J: New Revenue Generated"
- Illustration 4.10, "Schedule K: Contractor Support Costs"
- Illustration 4.11, "Schedule L: Contractor Monitoring Costs"
- Illustration 4.12, "Schedule M: Revenue Generated From Asset Conversions"
- Illustration 4.13, "Schedule N: Conversion Costs"
- Illustration 4.14, "Schedule O: Personnel Conversion Costs"

Illustration 4.8

Schedule I: Contractor Costs

Purpose. Use the contractor costs worksheet to accumulate and calculate the contract price of the outside contractor or provider for the contract period, including projected cost increases over the term of the contract. The worksheet also accumulates the information calculated on any revenue decreases (including lost user fees, grants, subsidies, or investment income) and credits for new revenues to be generated if the target function or activity is contracted to an outside contractor or provider. This outside contractor or provider cost information is used in calculating total net outside costs for comparison to in-house relevant costs.

Instructions. Schedule I is completed using the contract bid prices from the RFP response, estimates of revenue decreases, lost grants or subsidies, and new revenue information calculated and carried forward from Schedule J (illustration 4.9). For this reason, Schedule J, to the extent applicable, must be completed before the preparation of Schedule I. Schedule I, Line A, is used to record the contractor's bid price over the term of the contract, including projected cost increases or decreases. The transfer of the target function or activity to an outside contractor or provider, specifically a provider in the private sector, can also result in increases or decreases to ongoing revenues of the transferring entity.

- *Revenue decreases.* Consider any loss of charges, fees, or other revenues from transferring the service. Such lost revenue could include fees no longer collected, grants or subsidies no longer available, and loss of investment income, if applicable.
- *Revenue increases* (see Schedule J). Also consider any new or enhanced revenues that will be generated from the transfer.

Lines B and C of Schedule I are used to record the estimated revenue decreases and lost grants or subsidies, if any, resulting from transferring the target function or activity to the outside contractor. These amounts should be estimated for each contract period. Use line D of Schedule I to record any other contractor costs or lost revenue not specifically included in lines A, B, and C. The outside contractor's or provider's proposed cost, plus any lost revenue, grants, or subsidies, are then subtotaled on line E. From this subtotal, any new revenues to be generated (from Schedule J) are subtracted on Line F to arrive at the total net contractor's cost on line G. This Schedule I net cost information is ultimately carried forward to Schedule A, the Summary of Relevant Costs (illustration 4.15), Line E.

Example. The example (see the completed form, opposite) indicates total annual contractor costs, net of new revenue generated, of $466,000, $491,000, and $517,000 over the three-year contract period applicable to performing the example target activity. These costs are the proposed ongoing operating costs, net of anticipated changes to revenues, to be incurred each year through the life of the contract as quoted in the proposal of the selected outside contractor or provider, amended by any final negotiations. These costs are normally the direct payments made to the outside contractor for the transferred services. In this example, the contractor's bid price is reduced by a $34,000 (see Schedule J) credit for new revenues to be generated each year from transferring the target activity to the outside contractor to arrive at the net contractor's cost.

Illustration 4.8 *(continued)*

Schedule I: Contractor Costs*
Completed Form

AGENCY: Example Entity   TARGET ACTIVITY: Example Activity

	Contract Period 1	Contract Period 2	Contract Period 3
A. Contract price (a)	$500,000	$525,000	$551,000
B. Decrease in user fees (b)	0	0	0
C. Lost grants or subsidies (b)	0	0	0
D. Other contractor costs (b)	0	0	0
E. Subtotal (lines A+B+C+D)	$500,000	$525,000	$551,000
F. Credit for new revenues (c)	($ 34,000)	($ 34,000)	($ 34,000)
G. Total net contractor cost (d) (lines E–F)	$466,000	$491,000	$517,000

Footnotes:
(a) Assumes first year contract price of $500,000 and a 5% annual increase in contract price in the remaining contract periods.
(b) Calculation of any loss of revenue or other contractor costs anticipated from contracting out. None anticipated in this example.
(c) Anticipated new revenue resulting from contracting with an outside provider. Total carried forward from Schedule J, illustration 4.9.
(d) Enter total net contractor costs on Schedule A, Line E, illustration 4.15.

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Illustration 4.9

Schedule J: New Revenue Generated

Purpose. Use the new revenue generated worksheet to calculate the estimated new annual revenue, if any, resulting from transferring the target function or activity to an outside contractor or provider. These new annual revenues are credited against outside contractor costs to calculate total net contractor costs.

Instructions. Identify and calculate the total of new revenue estimated to be generated annually resulting from transferring the target function or activity to the outside contractor or provider. The total is carried forward to Schedule I, Contractor Costs (illustration 4.8), Line F, and is netted against the subtotal of contractor costs. Any estimated revenue increases or decreases over the contract period should be considered in the projections.

Example. The example (see the completed form, opposite) indicates new annual revenue totaling $34,000, resulting from $10,000 of estimated new sales taxes and $24,000 of revenue contractually shared by the outside contractor or provider with the entity (for example, a percentage of contractor income). While many of these revenues are more applicable to governments than not-for-profit organizations, they should be considered for both. Such revenues could include the following:

- *Tax revenues.* If the outside provider is a for-profit entity, a government could be entitled to new tax revenues, including sales tax, property tax, and franchise tax.
- *Shared fees.* In some cases, the new service provider may agree to share a portion of the revenue collected with the transferring entity.
- *License and permit fees.* In many cases, the new provider may be required to pay for certain operating licenses and permits to conduct its business.

Illustration 4.9 *(continued)*

Schedule J: New Revenue Generated*
Completed Form

AGENCY: Example Entity TARGET ACTIVITY: Example Activity

	Contract Period 1	Contract Period 2	Contract Period 3
New tax revenue (a)	$10,000	$10,000	$10,000
Other new revenues:			
Shared revenues from contractor (b)	$24,000	$24,000	$24,000
Total new revenues (c)	$34,000	$34,000	$34,000

Footnotes:

(a) Calculation of estimated new tax revenue (for example, sales, property, and franchise) to be generated from the new service provider over the contract period. In this example, the same amount of new tax ($10,000) is estimated annually for the three-year contract period.

(b) Calculation of estimated other, nontax, revenues to be generated from contracting out. In this example, the contractor has agreed to share $2,000 per month of their revenue ($24,000 annually) over the contract period with the entity.

(c) Total of anticipated new revenue generated. Enter on Contractor Costs Schedule I, Line F—Illustration 4.8.

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Illustration 4.10

Schedule K: Contractor Support Costs

Purpose. Use the contractor support costs worksheet to identify and calculate the estimated cost of space, equipment, or staff, if any, that the government or not-for-profit organization will provide to the outside contractor. These costs are included in total outside provider costs to provide for a fair comparison to relevant in-house costs.

Instructions. When ongoing operations are transferred to a new provider, the government or not-for-profit organization may lend or transfer to the new provider existing program facilities, equipment, or staff or incur other costs for the benefit of the outside contractor or provider. These costs should be considered in the RFP and specifically included in any contract with the new contractor or provider. These contractor or provider support costs are included for each year of the proposed contract as applicable. Any additional costs are determined for each contract period related to outside contractor or provider support, and recorded on the appropriate lines of Schedule K in the appropriate contract period columns. Anticipated cost increases, if any, over the contract period should be considered. The total support costs for each contract period is carried forward to Schedule A, the Summary Relevant Costs (illustration 4.15), Line F.

Example. The example (see the completed form, opposite) indicates the outside contractor or provider will be provided office space at a cost to the contracting entity of $1,000 per month, or a total of $12,000 per year, for each of the three contract periods. In addition, it is estimated that the facility used by the contractor or provider will require approximately $2,000 of janitorial maintenance per year. As a result, outside contractor or provider support costs are estimated at $14,000 per year.

Illustration 4.10 *(continued)*

Schedule K: Contractor Support Costs*
Completed Form

AGENCY: Example Entity TARGET ACTIVITY: Example Activity

	Contract Period 1	Contract Period 2	Contract Period 3
Space provided (a)	$12,000	$12,000	$12,000
Equipment provided			
Facility maintenance provided (b)	$ 2,000	$ 2,000	$ 2,000
Other provisions:			
Total contractor support cost (c)	$14,000	$14,000	$14,000

Footnotes:

(a) Space costs to be incurred by the contracting entity for the benefit on the contractor. In this example, the contract provides for the entity to lease office space for the contractor at a cost of $1,000 per month ($12,000 annually) over the three-year contact period, and assumes no cost increases over the contract period.

(b) Facility maintenance costs to be incurred by the contracting entity for the benefit on the contractor. In this example, the contract provides for the entity to provide janitorial services for the leased facility at a cost of $2,000 per year over the three-year period.

(c) Total contractor support costs over the contract period. Enter totals in the appropriate periods on Schedule A, Line F (illustration 4.15).

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Illustration 4.11

Schedule L: Contractor Monitoring Costs

Purpose. Use the contractor monitoring costs worksheet to identify and calculate the total anticipated costs to be incurred related to implementing the performance monitoring plan for contractor performance. These monitoring costs are included in total outside costs to provide for a fair comparison to in-house relevant costs.

Instructions. The contract monitoring costs are those considered necessary to implement the performance monitoring plan (see chapter 3). Contract monitoring costs include those costs the government or not-for-profit organization will incur to administer the contract should it be awarded to the outside contractor or provider. These costs may include site inspector costs, ongoing performance monitoring or audit costs, contract management costs, and complaint office costs. Contractor monitoring costs specifically applicable to the contract should be recorded on the appropriate cost category lines of Schedule L. The outside contractor or provider monitoring costs must be included for each year of the proposed contract as applicable with increases in costs projected over the contract term. The total outside contractor or provider monitoring costs for each contract period are carried forward to Schedule A, the Summary of Relevant Costs (illustration 4.15), Line G.

Example. The example (see completed illustration 4.11) indicates that annual contract monitoring costs are estimated at $30,000, $31,500, and $33,000 over the three-year contract term. The monitoring costs include the personnel costs of a new inspector who will be used exclusively for monitoring the outside contractor or provider and estimated internal audit charges to be incurred for periodic contract audit services.

Illustration 4.11 *(continued)*

Schedule L: Contractor Monitoring Costs*
Completed Form

AGENCY: Example Entity   TARGET ACTIVITY: Example Activity

	Contract Period 1	Contract Period 2	Contract Period 3
Personnel Costs of Monitoring Staff: (a)			
Salaries and wages	$20,000	$21,000	$22,000
Benefits	3,000	3,150	3,300
Other monitoring costs: (a)			
Internal audit charges	7,000	7,350	7,700
Total contractor monitoring costs (b)	$30,000	$31,500	$33,000

Footnotes:

(a) This example assumes the hiring of a contract inspector and incurring new internal audit charges for contract auditing. Assumes a 5% annual increase in personnel and internal audit costs over the three-year contract period.

(b) Enter total contractor monitoring costs in appropriate periods in Schedule A, Line G (illustration 4.15).

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Illustration 4.12

Schedule M: Revenue Generated From Asset Conversions

Purpose. Use the schedule of revenue generated from asset conversions to identify and accumulate the one-time net proceeds to be received by the government or not-for-profit organization from the disposition of any capital assets through transferring the target function or activity. These proceeds are used to offset the gross outside contractor costs, to arrive at total net outside costs for a fair comparison to in-house relevant costs.

Instructions. If the transfer of service involves the disposition of land, buildings, equipment, or other capital assets, one-time proceeds resulting from the disposition must be considered in determining total net outside contractor or provider costs. Such proceeds should be reflected in the contract period in which they are to be received as a reduction of total outside costs. For capital assets disposed, transferred, or otherwise converted, the gross sales or disposition proceeds are calculated and recorded in Schedule M, Column A. Next, subtract any costs associated with the sale or disposition and record in Schedule M, Column B. Finally, record the net proceeds in Schedule M, Column C. The total net proceeds are then carried forward to Schedule A, the Summary Relevant Costs (illustration 4.15), Line I, in the contract period they will be received.

Example. The example (see the completed form, opposite) assumes the outside contractor or provider will acquire five trucks for $80,000 and certain mowing equipment for $32,000 from the entity for a total of $112,000. In the example provided, no costs are anticipated from selling the assets (such as advertising or title costs). As a result, the net proceeds are the same as the gross proceeds.

Illustration 4.12 *(continued)*

Schedule M: Revenue Generated From Asset Conversions*
Completed Form

AGENCY: Example Entity TARGET ACTIVITY: Example Activity

Description of Assets	A Sale/Disposition Gross Proceeds (a)	B Disposal Cost (b)	C Net Proceeds (Lines A – B)
5 Trucks	$80,000	0	$ 80,000
Mowing equipment	$32,000	0	$ 32,000
		Total (c)	$112,000

Footnotes:

(a) Gross proceeds from sale or disposition of assets. In this example, the assets will be sold to the outside contractor for $112,000, $80,000 for the five trucks and $32,000 for the mowing equipment.

(b) Any costs anticipated to be incurred in selling or disposing of the assets, such as advertising costs. In this example, there are no disposal costs since the outside contractor has agreed to buy the assets.

(c) Enter the total net proceeds in the contract period the proceeds will be received on Schedule A, Line I (illustration 4.15).

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Illustration 4.13

Schedule N: Conversion Costs

Purpose. Use the conversion costs schedule to identify and accumulate the summary one-time costs to be incurred from the displacement of employees and any other miscellaneous one-time costs resulting from the conversion of the target function or activity delivery to the outside contractor or provider. These costs are included in total outside contractor costs for a fair comparison to in-house relevant costs.

Instructions. The transition logistics and personnel plans (see chapter 3) form the basis from which to begin the accumulation of the one-time conversion costs that would be incurred if the service were transferred to an outside contractor or provider. These conversion costs can be classified as follows:

- *Transition logistics plan costs.* These costs include such one-time costs as data conversion costs, penalties for early terminations of agreements, and transfer of materials and supplies.
- *Personnel plan costs.* Personnel conversion costs are calculated on Schedule O, Personnel Conversion Costs (see illustration 4.14) for all employees to be displaced or any employees whose ongoing compensation will change. The personnel costs recorded on Schedule N represent the total amount carried forward from Schedule O. These total one-time conversion cost amounts are then carried forward to Schedule A, the Summary of Relevant Costs (illustration 4.15), Line J, for the contract period in which the costs are to be paid.

Example. The example (see the completed form, opposite) indicates that total one-time conversion costs are calculated to be $24,000. These costs, all of which will be incurred in the first contract period, include $20,700 of personnel conversion costs carried forward from Schedule O (illustration 4.14), and $3,300 of penalty cost from an early lease cancellation.

Illustration 4.13 *(continued)*

Schedule N: Conversion Costs*
Completed Form

AGENCY: Example Entity TARGET ACTIVITY: Example Activity

Category	Cost
Personal conversion costs (a)	$20,700
Additional conversion costs:	
Lease cancellation penalty (b)	3,300
Total (c)	$24,000

Footnotes:

(a) One-time costs related to personnel terminations or other changes resulting from contracting out. This total amount is carried forward from Schedule O (illustration 4.14).

(b) One-time costs, other than personnel costs, resulting from contracting out. In this example, a $3,000 penalty for early lease cancellation will be incurred.

(c) Enter total conversion costs in the contract period they will be paid on Schedule A, Line J (illustration 4.15). In this example, all conversion costs will be incurred in the first contract period.

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Illustration 4.14

Schedule O: Personnel Conversion Costs

Purpose. Use the personnel conversion cost schedule to accumulate the detail of the one-time costs that will have to be paid resulting from the displacement of employees affected by transferring the target function or activity service delivery to an outside contractor or provider. These costs are included in the one-time conversion costs component of total outside costs (see Schedule N, illustration 4.13).

Instructions. The personnel plan identifies the affected employees and plans for their displacement (see chapter 3) and forms the basis from which to accumulate and calculate the one-time personnel conversion costs that will be incurred by transferring the service to the outside contractor or provider. These conversion costs include all costs associated with displaced employees as a result of the transfer of service. Such costs would include severance pay, early retirement costs, accrued compensated absences, and related benefit or other employer costs. Identify and calculate any one-time payroll related costs, including applicable fringe benefit costs to be incurred from employee displacement or change. The total of these personnel conversion costs is then carried forward to Schedule N, Conversion Costs (illustration 4.13).

Example. The example (see the completed form, opposite) indicates total one-time personnel conversion costs of $20,700 resulting from the displacement of a department head and ten other employees of the example target activity. These employees will no longer be employed by the contracting entity when the target function or activity service is transferred to the outside contractor or provider. The personnel conversion costs applicable to these employees include the required payment, upon termination, of vested accrued leave and related fringe benefit costs. These costs would likely be incurred regardless of whether the employees are employed by the selected outside provider or simply terminated from employment.

Illustration 4.14 *(continued)*

Schedule O: Personnel Conversion Costs*
Completed Form

AGENCY: Example Entity TARGET ACTIVITY: Example Activity

Positions	A Average Hourly Wage	B Vested Leave Balance (Hours)	C Vested Leave Costs (A x B)	D Severance Pay	E Medicare & FICA (a)	F Retirement (a)	G Unemployment (a)	H Other	I Total
Department head (b)	$20	400	$ 8,000	$0	$720	$400	$ 80	$0	$ 9,200
10 Class II workers (b)	$10	1000	$10,000	$0	$900	$500	$100	$0	$11,500
								Total (c)	$20,700

Footnotes:
(a) These costs are a percentage calculation of fringe benefit costs associated with the personnel conversion gross pay in columns C and D.
(b) Employees no longer employed as a result of contracting out.
(c) Enter total in the Personnel Conversion Costs line of Schedule N (illustration 4.13).

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Step 4: Compare Relevant In-House Costs to Outside Costs

The final step in completing the cost analysis involves the comparison of the calculated relevant in-house costs to the total outside costs. The analysis illustrated in this publication suggests a two-tiered approach to making a cost related recommendation, as follows:

- *First decision tier.* This level compares the outside contractor's or provider's ongoing operating, support, and monitoring costs and ongoing revenue changes to the relevant in-house costs for providing the service. It would not include one-time conversion costs or resources, which are considered in the second decision tier discussed below. It may be desirable to establish a minimum cost-savings (for example, at least 10 percent) before proceeding to the second decision tier. In establishing a minimum savings level, professional judgment and any stated organization-wide goals should be considered. The 10-percent amount noted here is simply a suggested guideline for a relatively short-term contract period. For longer contract periods, it may be advantageous to consider contracting out with a lesser savings percentage. If minimum savings are not achieved, the recommendation from the cost standpoint would be to retain the service in-house.
- *Second decision tier.* This comparison examines the total net cost of outside provision of the service to the total relevant in-house costs for the entire contract period. This comparison includes the outside contractor's or provider's ongoing costs considered in the first tier plus the one-time conversion costs or resources generated compared to the total relevant in-house costs. If total outside costs are sufficiently lower than total relevant in-house costs in this analysis, the recommendation from the cost standpoint would be to transfer the service to the new provider.

Illustration 4.15

Schedule A: Summary of Relevant Costs

Purpose. Use the summary of relevant costs to accumulate total relevant in-house costs of the target function or activity (costs that can be avoided if the target function or activity is no longer performed in-house) and the total outside contractor or provider and conversion costs (the net costs of transferring the target function or activity to an outside contractor or provider). These costs are compared to determine which service delivery alternative is the most cost-effective.

Instructions. Schedule A is the final cost analysis schedule to be prepared. It is completed using the information calculated on the supporting Schedules B through O (illustrations 4.1 through 4.14). As a result, Schedules B through O, to the extent applicable, must be completed before the preparation of Schedule A. The amounts from the supporting schedules for each applicable period are carried forward to their corresponding lines in Schedule A. Once Schedule A includes the amounts from the supporting schedules, calculate the various subtotals on Lines D, H, K, and L to perform the two-tiered decision. The first-tier decision is made by calculating the difference between the total relevant in-house costs on Line D and the total contractor operating costs on Line H. If the total column of Line H is less than the total column of Line D by at least the level of desired cost savings (for example, 10 percent or more), then proceed with the second-tier decision. The second-tier decision is made by calculating the difference between the total relevant in-house costs on Line D and the total outside costs on Line L. If the total column of Line L is less than the total column of Line D, then there exists an overall savings and the decision-makers should consider recommending the award of the contract to the outside contractor or provider from the cost-effectiveness standpoint.

Example. The example (see the completed form, opposite), indicates a total of relevant in-house costs of the example target activity of $534,000 for the prior year (historical), $557,000 for the current year, and a projection of $1,855,550 for the three-year contract period. The total outside contractor operating costs are $1,610,500, and the total outside costs for the three-year contract period are $1,522,500. All the historical, current year, and contract period costs summarized in this illustration are costs that have been identified, accumulated, and determined to be relevant from other supporting cost analysis schedules (see Schedules B through O, in illustrations 4.1 through 4.14). In the illustrated example, total outside contractor operating costs over the three-year contract period are projected to be $245,050 less than relevant in-house costs ($1,855,550 – $1,610,500), or a 13 percent savings through contracting out. In addition, total outside costs over the contract period, including one-time net conversion costs or net resources, are projected to be $333,050 less than relevant in-house costs ($1,855,550 – $1,522,500). As a result of these projected savings, a recommendation is made to consider awarding the contract to the outside provider from the standpoint of cost-effectiveness.

Illustration 4.15 *(continued)*

Schedule A: Summary of Relevant Costs*
Completed Form

AGENCY: Example Entity   TARGET ACTIVITY: Example Activity   DATE: xx-xx-xx

	Review Periods' Relevant Costs					
Cost Category	Historical Year	Current Year	A Contract Period 1	B Contract Period 2	C Contract Period 3	Contract Period Total (Lines A+B+C)
In-house delivery						
A. Relevant direct costs (Schedule B)	$509,000	$530,000	$ 561,000	$588,750	$618,300	**$1,768,050**
B. Relevant indirect costs (Schedule H)	25,000	27,000	28,000	29,000	30,500	**87,500**
C. Adjustments	0	0	0	0	0	**0**
D. **Total relevant in-house costs** (Lines A+B+C)	**$534,000**	**$557,000**	**$ 589,000**	**$617,750**	**$648,800**	**$1,855,550**
Outside delivery						
E. Contractor costs (Schedule I)			$ 466,000	$491,000	$517,000	**$1,474,000**
F. Contractor support costs (Schedule K)			14,000	14,000	14,000	**42,000**
G. Contractor monitoring costs (Schedule L)			30,000	31,500	33,000	**94,500**
H. **Total contractor operating costs** (Lines E+F+G)			**$ 510,000**	**$536,500**	**$564,000**	**$1,610,500**
I. Net proceeds - from asset conversions (Schedule M)			(112,000)	0	0	**(112,000)**
J. Conversion costs (Schedule N)			24,000	0	0	**24,000**
K. **Total one-time costs (proceeds)** (Lines I+J)			**$ (88,000)**	**$ 0**	**$ 0**	**$ (88,000)**
L. **Total outside costs** (K+H)			**$ 422,000**	**$536,500**	**$564,000**	**$1,522,500**
Operating cost savings (Line D Total Less Line H Total) If positive and 10 percent (a) or more of Line D, then continue below.						**$245,050 or 13%**
Total relevant cost savings (Is Total Column of Line L less than Total Column of Line D?) If yes, then consider awarding to outside provider.						**$333,050 / Yes**

Footnotes:

(a) In this example, the 10 percent savings represents the minimum level of operational cost savings required for the entity to further consider contracting out. This desired savings percentage is a matter of policy and should be addressed by each entity considering introducing competition.

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CONCLUSION

The consideration of competition and its use in government or not-for-profit organizations can be achieved through a CPA's solid financial analysis in quantifying costs, savings, and other monetary considerations. The cost analysis assists in analyzing other important competition and financial criteria and is an essential component of the decision-making process.

Once completed, the cost analysis can be used as a basis for one of the selection criteria in the decision summary, for preparing a recommendation report, and for gathering supporting documentation, such as a summary of relevant total costs. These materials are forwarded to the competition task team for their review. Upon further review and action, these materials can then become the basis for the final decision reached by the evaluation committee. (See chapter 5, "Provider Selection: How to Make and Implement the Selection Decision," for a complete discussion of how to make and implement the final provider selection decision.)

Exhibit 4.1

Suggested Bases for Indirect Cost Allocation*

These bases may be useful for equitable allocation of indirect costs. These are not mandatory or all-inclusive. Determine what is appropriate for each situation.

Allocation of indirect costs on a total basis:

Total personnel costs (personnel costs of the target function or activity divided by the organization's total personnel costs)

Total direct costs (direct costs of the target function or activity divided by the organization's total direct costs)

Total number of full time equivalent employees (FTEs) (number of target function or activity FTEs divided by the organization's total FTEs)

Allocation of indirect costs by service type:

Service	*Possible Allocation Base*
Accounting	Number of transactions processed
Accounts payable	Checks/warrants issued and transactions processed
Auditing	Audit hours
Budgeting	Hours expended
Building lease management	Number of leases
Data processing	System usage and programmer hours
Equipment maintenance and repairs	Hours expended
Human resources	Number of employees and FTEs
Legal services	Hours expended on service completion
Mail and courier service	Number of documents handled, number of employees served, and pick-up points
Motor pool costs	Miles driven and days used
Office space use	Square feet of space occupied
Payroll	FTEs, number of employees, and number of checks printed
Printing and reproduction	Hours expended and pages printed
Procurement	Total proposals and contracts processed
Utilities	Square feet of space occupied

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Exhibit 4.2

Sample Request for Proposal

This illustration material is intended as a sample only. It is included with the understanding that the publisher, author, contributors, and editors are not rendering legal or other professional services. Practitioners are advised to consult legal counsel for specific advice on the appropriateness of this material for their own use.

Chapter 4 addresses the necessary components of a request for proposal (RFP) to be submitted to interested service providers. The RFP represents a formal commitment by the government or not-for-profit organization to proceed with the competition effort. Release of an RFP demonstrates the seriousness of its consideration. The RFP must incorporate the issues addressed in the planning phase, including the transfer logistics plan, personnel plan, and performance monitoring plan. For example, the RFP should include service delivery requirements that will meet the desired performance measures established in the performance monitoring plan. The RFP should be comprehensive and complete in order to minimize any misunderstandings between the requesting and proposing parties. It should be designed in a manner to allow for its inclusion by reference into a contract with the selected contractor or provider.

I. Introduction

A. Purpose of the Request for Proposal (RFP)

The City of Example, Any State, is seeking RFPs from qualified Information Technology Management Firms wishing to participate in a negotiated procurement to secure private management of City's Data Processing and Telecommunications operations. The City is seeking to strengthen the cost-effectiveness, quality, customer responsiveness, integration, and productivity of its data processing and telecommunications services. The primary objectives are to:

- Improve the quality of data processing and telecommunications technical and customer service deliverables in the most cost-effective manner.
- Develop mechanisms for improving City's use of its Data Processing and Telecommunications resources.
- Improve the overall effectiveness of city-wide operating expenses and capital expenses associated with data processing and telecommunications.

The City's goal is to find the most cost-effective and customer-service driven method of managing its Information Systems, and to remain current with technology initiatives.

B. Business Environment

City of Example is a home-rule, incorporated city with a population of 95,050. The City encompasses approximately thirty-six square miles. One of the fastest-growing cities in Any State, Example is the ninth largest city in the Metroplex. Recently named the "Best Suburb" by a local magazine, Exampleians enjoy good parks, good libraries and recreational facilities, and diverse neighborhoods.

The City has a Council/Manager form of government. The City Council is an elected body consisting of the Mayor and seven council members. The City Manager is responsible for all functions of City government. The organization is divided into functional departments and divisions reporting to either the City Manager or two Assistant City Mangers. Over 900 City employees provide numerous services to residents, businesses and visitors. The total 20XX–20XX City budget is $XXX,XXX.

The City of Example organized an information technology reengineering initiative to lead a customer-driven reexamination of the way the City organizes, staffs, and budgets for the delivery of data processing, telecommunications, and management information services. After assessing conditions, it was concluded that the City should take steps necessary for the long-term strategic delivery of quality data processing and telecommunication services on an outsourced basis. The City is looking for a long-term business partner to deliver customer-driven, integrated technology services to assist the City in maximizing its investment in technology.

Exhibit 4.2 *(continued)*

C. Scope

The scope of this RFP is broadly covered under the management of the City's Data Processing and Telecommunication functions. Responsibilities include all operating duties associated with the City's mainframe computer system, microcomputers, networks, and telecommunication systems, including voice mail, cellular telephones, and paging systems. The expectation is the qualified firm will provide comprehensive management, operating support, maintenance, and customer service satisfaction to the users of these systems.

The City of Example desires to form a relationship with a vendor that can provide a management solution that includes the following:

- Packaged application and system software selection and implementation support
- Modifications to application and system software as required
- Conversion and implementation support for third-party software packages
- Ongoing maintenance support of software and hardware
  —Maintenance and repair of hardware
  —Coordination of activities with packaged software vendors
  —Software programming services
  —Technical assistance for packaged software upgrades
  —Technical assistance for hardware upgrades
- Operations and maintenance support
  —System capacity planning
  —System backup management
  —System security
  —Batch printing
  —Network management and planning
  —Disaster recovery
- Telecommunications
  —Switch programming
  —Line and cellular phones
  —Voice mail system programming
  —Call accounting programming
  —Moves and changes request
  —Panic alarms
- Other required services
  —Help desk operations
  —Training
  —Microcomputer and personal computer (PC) support
  —LAN support and maintenance
  —Network implementation, including interconnectivity, e-mail, and calendar/scheduling applications
  —Internet connection and management
  —Geographic information systems coordination

The successful firm will demonstrate the ability to provide a reliable networked technology infrastructure and maintain high system availability for all network and application servers. In addition, the firm will demonstrate its ability to provide exceptional technical advisory services to City departments. The focus of the qualifications review will be on customer service satisfaction and support.

Exhibit 4.2 *(continued)*

The following major systems will be supported:

- Finance
- Human resources
- Building inspection
- Utility billing
- Geographic information systems
- Work order system
- Municipal court
- Tax
- Code enforcement

Police and Fire emergency dispatch and records management systems, and 911 telephone operations are *not* included in the scope of work. The Library's computer system software (with the exception of peripherals included in the PC inventory) is *not* included in the scope of work.

II. Current Computer and Telephone Services Environment

A. Data Processing Environment

1. Staffing

   [*List specific staff and numbers here.*]

2. Mainframe Hardware and System Software

   [*List and describe specific mainframe hardware and system software, including software versions, here.*]

3. Software Applications

   [*List specific application software, including software name, provider, and version.*]

4. Local Area Networks

   [*List specific networks, including server hardware, software, and applications running on the network.*]

5. Microcomputers and Peripherals

   [*List specific hardware and peripheral equipment.*]

6. Microcomputer Software Applications

   [*List specific application software, including software name, provider, and version.*]

B. Telecommunications Environment

1. Staffing

   [*List specific staff and numbers here.*]

2. Phone Switches (2)

   Phone Instruments and Lines

   [*Describe specific phone and alarm systems here.*]

3. Voice Mail System

   [*Describe specifics of voice mail system here.*]

4. Pagers

   [*Describe pager operations, including number of pagers, and the transmitting software and contractor.*]

Exhibit 4.2 *(continued)*

5. Cell Phones

   [*Describe cell phone operations, including number of phones, and the current contractors.*]

6. Microwave System

   [*Describe microwave system and call routing process here.*]

III. Submission of Qualifications

A. Business Organization

State the full name and address of your organization and whether you operate as an individual, partnership, or as a corporation. If a corporation, include the state in which you are incorporated. In addition, provide the following:

- Year established
- Type of services provided
- Number of employees in your firm and the number with relevant technical and functional experience.
- Documented corporate financial resources, to ensure the continued ability of your firm to fulfill all contractual obligations.

B. Relevant Prior Experience

Demonstrate relevant prior experience and corporate resources in providing similar technical, functional, and management services to local governments, specifically those compatible in scope and complexity to the City of Example. Include at least three clients for which you are providing management, technical, and functional assistance. State the client name, duration of contract services, scope of services, and key contacts. Requirements should include a minimum of three years of experience in providing similar computing and management services to local governments. Provide the company name, address, contact name, and phone number of the last three firms that have discontinued outsourcing service with your firm. This should be the *last* three, regardless of reason.

C. Needs Analysis and Planning

Describe what your methodologies would be for taking inventory of and evaluating the City's data processing and telecommunication resources.

Discuss your approach for acquiring, implementing, and supporting advanced technologies, such as geographic information systems, micro computer/PC-based report writing tools, automated call distribution (ACD), paging distribution, imaging, records management, permits and inspections, licensing, reservations, public access to information, remote access to services, office automation, executive information systems, and client/server systems.

D. Firm Personnel

Provide résumés of key personnel of your firm who will have assignment to the City.

E. Approach and Methodology

Describe your firm's approach and methodology to improving and maintaining customer service at a high level of responsiveness. Elaborate on processes you have implemented that achieved exceptional customer service with existing clients. Also, describe what your approach and methodology would be for improving the City's technology infrastructure as described in this RFP.

F. Employment of City Staff

Provide the detailed process and procedures you would follow to employ all of the City of Example data processing and telecommunication employees in similar positions within your organization. In addition to your plan as requested above, provide adequate detail that will provide your firm's track record, policy, and practice in retaining outplaced personnel.

Exhibit 4.2 *(continued)*

G. Systems Development Experience

Provide a concise description of your firm's capabilities in the area of application development for jurisdictions similar in scope to the City of Example. This should include applications developed from scratch, acquired from third-party vendors, and your firm's proprietary software, if applicable.

H. Remedies for Defective Performance

Provide a statement about whether your firm will agree to contractually negotiated remedies for failure to meet performance standards (see Attachment A) for system availability and production that would include, but not be limited to, credits to the vendor fees due.

I. Contract Period and Fees

The City plans to enter into a five-year contract with the selected contractor or service provider. Provide an estimate of fees and expenses for the performing the services as defined in the scope section of this request. The fees proposed should include any anticipated increases or decreases over the contract term.

J. Additional Information

If additional information is necessary to enable you to better interpret the information contained in the RFP, questions *must* be directed to the RFP Committee Chairperson. Questions from all vendors will be consolidated and mailed only to the vendors who attend the RFP Vendor Information Session.

The RFP Vendor Information Session will be conducted on Wednesday, May XX, 20XX, from 2:00 P.M. to 4:00 P.M., in City Council Chambers, Example City Hall, 2nd Floor, 1945 Example Road, Example, Any State XXXXX-XXXX.

IV. Evaluation of RFP Responses

A. Critical Success Factors

1. Rapid development of a city-wide enterprise network. Provide infrastructure for interfacing existing systems.
2. Provide standard guidelines for network protocol, PC software, network interconnectivity, and microcomputer hardware configuration and cabling.
3. Maintain reliable high-speed communications to remote building locations.
4. Develop and maintain a first-class help desk operation to provide timely customer support for technology related issues.
5. Provide networked Internet access solution.

B. Evaluation Process

1. The City of Example will process RFP responses in accordance with criteria below. The City reserves the right to reject any and all RFP responses and shall be the sole judge of the quality of the qualifications and the sole party to determine which of the RFP responses constitute the best firms. The decision of the City will be final.
2. Selected management personnel and City Council members will form the Evaluation Committee for the RFP responses. It will be the responsibility of this committee to evaluate all properly prepared and submitted proposals and make a recommendation to the City Manager. The City Manager will make a recommendation to the City Council and seek approval to negotiate an outsourcing contract.
3. Each response will be evaluated on its merits.

Exhibit 4.2 *(continued)*

4. Based upon the performance measurement requirements and volumes present within Attachment A to this RFP, a realistic response structured specifically for the City of Example to achieve its desired outcomes is expected.

5. Required copies are the following:

   a. Firms must submit one (1) original and five (5) copies of their RFP. Six (6) copies of documentation or other descriptive literature must be submitted with the response.

   b. Proprietary information submitted in response to the RFP will be processed in accordance with applicable procurement procedures. Portions of the vendor's response to this RFP that are proprietary should be identified as such. The City will appropriately protect such information from public examination. Otherwise, proposals and documents pertaining to the RFP become property of the City and shall be open to the public, within the limits of Any State law.

6. *Selection criteria.* Any contract resulting from this RFP shall be awarded to the firm providing the best proposal to the City. After determining responsiveness, qualifications will be evaluated in accordance with the following criteria:

   - Support
     —Operating systems, computer operations, and communications management
   - Comprehensive service offerings
     —Compatibility of firm's service offerings with City's requirements. Include examples of the help desk operations and enterprise-wide network support.
   - System availability
     —In-place capabilities to accommodate City's data processing and telecommunications load
     —Daily online and batch processing availability consistent with City's schedules
   - Flexibility
     —Ability to adapt to significant changes in processing requirements and capacity
     —Willingness to adapt to and support current and future City processing requirements
   - Vendor stability
     —The degree to which the firm can be expected to support proposed service levels
     —Financial and operational strength and reputation
     —Personnel transition
   - References
     —Must be from customers currently using firm's computer outsourcing or facility management
   - Cost
     —The competitiveness of the fees proposed over the contract term

7. After an initial review and compilation process, a technical question and answer conference or interview may be conducted, if deemed necessary, to clarify or verify the firm's proposal and to develop a comprehensive assessment of the proposal.

8. The City may request site visits to the location of references.

9. The City reserves the right to consider historic information and fact, whether gained from the vendor's proposal, question and answer conference, references, or any other sources, in the evaluation process.

Exhibit 4.2 *(continued)*

10. The firm is cautioned that it is the firm's sole responsibility to submit information related to the evaluation categories. The City is under no obligation to solicit such information if it is not included with the firm's response, provided, however, the City reserves the right to seek additional information as it becomes necessary. Failure of the firm to submit such information may cause an adverse impact on the evaluation of that firm's qualifications.

11. The firm shall make oral presentations, written presentations, or both, of the qualifications if requested by the RFP Committee Chairperson. These presentations will be held subsequent to the opening of proposals to provide firms an opportunity to clarify their qualifications. The RFP Committee Chairperson will schedule the time and location of each presentation.

V. Milestone Dates

April XX, 20XX	Release RFP
May XX, 20XX	RFP Firm Information Session Wednesday, May XX, 20XX, 2:00 P.M. to 4:00 P.M.
May XX, 20XX	RFP responses due
June 20XX	Analysis and evaluation of RFP responses Site visits (City of Example and firm sites) Selection
July 20XX	Contract negotiations
August 20XX	Recommendation to City Council
September 20XX	Transition to outsourcing firm

RFP committee chairperson:

Ms. Jane Doe
Information & Technology Team Leader
City of Example
P.O. Box xxxxxx
City of Example, Any State XXXXX-XXXX
Voice (xxx) xxx-xxxx   Fax (xxx) xxx-xxxx

VI. Attachments:

A. Contract Performance Measurement Indicators and Desired Outcomes
[*Example provided; see attachment at end of this exhibit.*]

The following information could also be provided as attachments [*examples not provided*]:

B. Example Annual Budget & Plan of Municipal Services

C. City of Example Organizational Chart

D. Information Technology Capital Expenditures 20XX–20XX

E. Telecommunications Operating Budget Summary, 20XX–20XX

F. Data Processing Operating Budget Summary, 20XX–20XX

G. Microcomputer and Peripherals Inventory

H. Phone Switch Inventories

I. Telephone Instrument and Phone Line Inventory

Exhibit 4.2 *(continued)*

Attachment A

Contract Performance Measurement Indicators and Desired Outcomes

PERFORMANCE INDICATORS

This section contains the narrative of the performance indicators and desired outcomes. Each service level is stated with a detailed narrative of service deliverables, premises, and responsibilities. The performance measures are organized into the following general areas:

I. Systems Availability
II. Scheduled Services
III. Requests for Service

I. Systems Availability: Workstations

Service response	Availability: workstations
Performance indicator	99%
Description	Availability is the percentage of hours that workstations have access to the mainframe, servers, processors, and operating and telecommunications systems are available, less scheduled outages and excluding systems failures outside contractor's control.
Evaluation period	Monthly
Performance indicator premises	Indicator applies to all information technology systems.
City responsibilities	City funds contractor-recommended mainframe hardware replacements.
Contractor responsibilities	Contractor performs evaluation of all systems and provides appropriate recommendations. Contractor coordinates and schedules periodic maintenance.
Reporting	Quarterly report depicting performance indicator

I. Systems Availability: Response Time

Service response	Systems response time of 2 seconds Maximum response time of 4 seconds
Performance indicator	95% on systems response time 100% on maximum response time

(continued)

Exhibit 4.2 *(continued)*

I. Systems Availability: Response Time *(continued)*

Description	All systems should respond on inquiry to users within 2 seconds 95% of the time with a maximum response time of 4 seconds 100% of the time, less scheduled outages and excluding systems failures outside contractor's control.
Evaluation period	Quarterly
Performance indicator premises	Indicator applies to all information technology systems, excluding dial up.
City responsibilities	City funds Contractor-recommended mainframe hardware replacements.
Contractor responsibilities	Contractor performs evaluation of all systems and provide appropriate recommendations. Contractor coordinates and schedules periodic maintenance.
Evaluation procedure	City and Contractor shall jointly measure performance at a predetermined date once per month to obtain a quarterly performance average. Three (3) different locations shall be selected, with actual measurement being performed by Contractor representative and City Contract Administrator or their designee. A stopwatch will be used to record and document the measure. The measure will be from the time the station enters inquiry until the response is received.
Reporting	Quarterly report depicting performance indicator

II. Scheduled Services

Service Response	Production schedule
Performance indicator	100% on time, as scheduled
Description	The schedule describes on-time production of payroll, utility billing, tax billing, W2s, and 1099s, excluding failures outside contractor's control.
Evaluation period	Quarterly
Performance indicator premises	This indicator applies to the production of items that are a necessary function to operate a City on a daily basis. Contractor and City staff will mutually establish processing and production schedules.

Exhibit 4.2 *(continued)*

II. Scheduled Services *(continued)*

City responsibilities	City will coordinate with Contractor a mutually established production schedule.
Contractor responsibilities	Contractor is to develop process to monitor and report performance indicator.
Reporting	Quarterly report depicting actual results versus performance indicator
Service response	Production of system management and periodic reports.
Performance indicator	100% on time, as scheduled
Description	This schedule of services is a means to produce systems management and usage reports with recommendations for hardware, equipment, and software improvements as necessary. This includes trend and failure analysis.
Evaluation period	Monthly
Performance indicator premises	Indicator applies to all activities associated within information technology and other departments as necessary.
City responsibilities	City is to review and consider recommendations.
Contractor responsibilities	Contractor is to evaluate systems and make recommendations. Contractor is to coordinate and schedule periodic maintenance.
Reporting	Monthly report depicting usage levels and recommendations

Service response	Annual customer service survey
Performance indicator	100%
Description	Contractor must provide friendly, professional service to all users of their services. Performance of an annual customer service survey to evaluate customer satisfaction
Reporting frequency	Annually
Performance indicator premises	Indicator evaluates customer service through responsiveness, professionalism, and effectiveness.

(continued)

Exhibit 4.2 *(continued)*

II. Scheduled Services *(continued)*

City responsibilities	City is to cooperate with periodic questionnaires and provide direct feedback.
Contractor responsibilities	Contractor establishes a culture that promotes the indicators.
Reporting	Annual report depicting results of survey

Service response	User group meetings
Performance indicator	Quarterly, or as scheduled
Description	Meetings are intended to develop improvements in customer service through user group feedback.
Reporting frequency	Quarterly
Performance indicator premises	Provide a mechanism for listening, participation and teamwork.
City responsibilities	City staff should agree to participate and provide feedback in user group meetings. City will designate staff who will be involved in user group meetings.
Contractor responsibilities	Contractor is to lead and participate in user group meetings.
Reporting	Quarterly report outlining feedback and recommendations from user groups

Service response	Quarterly newsletter to all users
Performance indicator	100% on time
Description	A quarterly newsletter will be developed and distributed to all information technology users to provide information on technology activities.
Reporting frequency	Quarterly
Performance indicator premises	This is designed to keep the City informed of information technology news, events, and future changes.
City responsibilities	City is to review and provide feedback to contractor.
Contractor responsibilities	Contractor is to prepare and distribute quarterly newsletter.
Reporting	Quarterly distribution of newsletter

Exhibit 4.2 *(continued)*

II. Scheduled Services *(continued)*

Service response	Desktop, network, and telecommunications training
Performance indicator	65 hours per month
Description	Training is to be provided to City staff in desktop, network, and telecommunications training.
Evaluation period	Quarterly, averaged annually
Performance indicator premises	An on-site location will be provided for City staff to become more effective and efficient in their positions.
City responsibilities	City is to fund the equipment and hardware for an on-site training center.
Contractor responsibilities	Contractor is to develop, schedule, and conduct on-site training.
Reporting	Quarterly reporting of performance indicator

III. Requests for Service

Help desk services are provided for the information technology systems. Help desk requests and responses may be provided in multiple forms (for example, phone, inter-office mail, e-mail, and fax).

Service response	Respond to customer requests within 2 business hours not to exceed a maximum of 4 business hours
Performance indicator	90%–2 hours 100%–4 hours
Description	Response is to be provided to supported City staff within 2 hours of a logged call to the help desk, where a follow-up assessment time frame will be given.
Evaluation Period	Quarterly
Performance indicator premises	Indicator applies to all incoming help desk requests. Support time applies to Monday through Friday, 8:00 A.M. to 5:00 P.M. excluding holidays.

(continued)

Exhibit 4.2 *(continued)*

III. Request for Service *(continued)*

City responsibilities	City is to fund contractor-recommended help desk system. City is to contact help desk directly for assistance. City is to have staff reporting incident be present when contractor staff responds.
Contractor responsibilities	Contractor is to establish help desk user procedures. Contractor is to log reported outage in help desk system and notify support staff. Contractor is to respond to City staff for assessment time frame.
	Contractor is to ensure that all users of any system are notified when systems are scheduled for down time or are down due to unscheduled problems.
Reporting	Quarterly report identifying status and recommended procedures and processes

Service response	Help requests and requests for services logged
Performance indicator	100%
Description	This service will log all help requests and requests for services.
Evaluation period	Quarterly
Performance indicator premises	Indicator applies to all incoming help desk requests. Support time applies to Monday through Friday, 8:00 A.M. to 5:00 P.M., excluding City holidays.
City responsibilities	City is to fund contractor-recommended help desk system. City is to contact help desk directly for assistance.
Contractor responsibilities	Contractor is to establish help desk logging procedures. Contractor is to log all reported requests and contacts in the help desk system.
Reporting	Quarterly report depicting actual results versus performance indicator

Chapter 5:

Provider Selection—How to Make and Implement the Selection Decision

After a thorough cost comparison has been performed of the cost of in-house versus outside performance of the target function or activity's service (see chapter 4), the decision-making process may reach its conclusion with the selection of an appropriate provider. The decision may be to select an outside contractor or provider, or to retain the in-house method of service delivery, including any recommended changes as identified in the planning or cost analysis steps. The selection decision is based on the consideration of selection criteria discussed in this chapter. This chapter provides assistance in advising the CPA's client or employer about:

- *Selecting a provider*, whether selecting a new outside provider or retaining the service delivery in-house, and making the recommendation to an evaluation committee
- *Developing a contract with the selected provider*, even if the target function or activity's service delivery is retained in-house, because a contract may be desirable to reinforce the notion of competition
- *Addressing implementation considerations of the plans,* including the performance monitoring plan, the personnel plan, and the transition logistics plan (if the service is transferred to a new provider)

The CPA can be an effective consultant to both the competition task team and the evaluation committee in making the final decision by communicating the results of the project and the selection recommendation. In addition, the CPA is uniquely qualified and trained to perform a significant portion of the performance monitoring activities. Specifically, the CPA can be involved in the following:

- Assisting the competition task team in making the decision about whether to recommend selecting an outside contractor or provider or retain the service delivery in-house
- Advising the client or employer regarding recommended changes to the target function or activity's method of service delivery, if the decision is to retain in-house delivery
- Assisting the client or employer and its legal counsel in preparing a contract for service and ensuring pertinent planning and request for proposal (RFP) issues are included
- Performing financial and compliance audits and performance monitoring activities

SELECTING A PROVIDER

Determining who should perform the target function or activity is essentially the final major decision to be made in the competition project. The decision is based on the selected provider's ability to meet the selection criteria, as outlined in the following section.

Selection Criteria

The CPA should consider the following criteria when assisting the competition task team in deciding on which provider to recommend selecting:

1. The provider agrees with the finalized scope of service to be performed.
2. The provider agrees to the performance monitoring plan and is capable of meeting the established performance standards.
3. The provider can meet the requirements of the transition logistics plan, if the service is to be transferred to a new provider.
4. The provider can meet the requirements of the personnel plan.
5. The cost analysis indicates the provider can provide the service cost-effectively.
6. The consideration of overall advantages and disadvantages of selecting a new provider indicates potential success.

The first five criteria are addressed in chapters 2 through 4. The sixth criterion for consideration by the competition task team in making a selection recommendation is covered here.

- Advantages of government or not-for-profit organizations providing the service include the following:
  —Lower cost of capital, especially for governments
  —Lower costs related to freedom from paying taxes (that is, freedom from income taxes for not-for-profit organizations and income, sales, and franchise taxes for governments)
  —Local knowledge of customers
  —Synergism of services, such as the engineering department assisting other departments
  —In governments, availability of tort liability limits and certain immunities
  —Retaining complete control of service provided
- Disadvantages of government or not-for-profit organizations providing the service include the following:
  —Potential for less flexibility in providing the service
  —More difficulty achieving cost savings due to lack of profit-motive
  —Lack of specialized expertise or adequate equipment for the service
  —Retention of risks associated with providing the service
- Advantages of the private sector providing the service include the following:
  —Performance positively affected by desire to generate profit
  —Possibility of achieving cost savings
  —More flexibility in providing service
  —Possibility of more specialized expertise and equipment
  —Transfer of certain risks associated with providing the service
- Disadvantages of the private sector providing the service include the following:
  —Contracts with outside contractors or providers may not anticipate subsequent changes in circumstances.
  —Contractor or provider may develop de facto monopoly.

—Government or not-for-profit organization may lose control over service provided.
—Contractor or provider may declare bankruptcy, be acquired, or default in the future.
—Employee morale may suffer from possible loss of jobs or other displacement.
—Private sector must pay taxes and normally incurs higher cost of capital.
—Political resistance may be encountered from elected officials, the public, or labor unions.

Appointing an Evaluation Committee

The purpose of the evaluation committee is to make a final decision on the selection of a provider as recommended by the competition task team. The competition task team's recommendation will involve the selection of one of two alternatives: (1) continue with in-house service delivery or (2) award a contract to the outside contractor or provider. The evaluation committee's decision may ultimately require approval by the governing body of the government or board of directors of the not-for-profit organization.

The makeup of the evaluation committee is a matter of preference. Appropriate composition of the evaluation committee would include representatives from the board of directors or management of the not-for-profit organization, the governing body or management of the government, the finance committee of the entity, employees appointed for this purpose, or service recipient groups.

Example. An example evaluation committee could include the following representation:

- The chief executive officer of the entity
- The chief financial officer of the entity
- The department or agency head of the target function or activity, or its designee
- A government citizen, customer, or not-for-profit organization client representative
- The CPA as an independent consultant

Making the Selection Recommendation

The evaluation committee should be provided with the results of the competition task team's cumulative work, including the qualitative analysis (see chapter 2), the planning decision worksheet (see chapter 3), and the cost analysis (see chapter 4), along with a consideration of the overall advantages and disadvantages of the final competition alternatives. The recommendation should focus on addressing the provider selection criteria discussed earlier in this chapter. While some of the criteria may indicate that selecting a new outside contractor or provider would result in positive results, other criteria may mitigate the positive and lead to a recommendation of retaining the service delivery in-house.

Example. A not-for-profit drug dependency clinic is considering outsourcing its core business function of treatment services. The cost analysis indicates that outsourcing could result in an 8 percent cost savings to the organization over the next three years. In addition, the transition logistics plan, personnel plan, and performance monitoring plan indicate that outsourcing the services could be effective. However, the not-for-profit management and board believe there are significant disadvantages to outsourcing its core business function. These disadvantages include potential loss of long-term competitive edge, possible short-term cost savings that are an insignificant amount, and possible loss of control over the primary function of the entire organization. As a result, a recommendation is made to retain the service and not outsource.

Example. A local government is considering privatizing its fire-fighting function. The cost analysis reflects a five-year cost savings of approximately 17 percent through awarding a contract to an outside provider. However, the negative impact on current employees along with significant concerns over the long-term viability of the outside provider and its perceived inability to meet desired performance standards resulted in a recommendation to retain the service in-house. The recommendation included suggestions to reengineer the service delivery by consolidating certain fire stations and realigning coverage areas of all stations to improve response time and reduce costs.

These examples illustrate that achieving a cost savings is not the only aspect considered in making the recommendation. Depending upon the final decision made by the evaluation committee, certain follow-up actions are needed.

Continuing to Provide Service In-House

If the government or not-for-profit organization decides to continue to provide the service, it may need to effect any changes that are suggested in the proposed in-house cost section of the cost analysis. For example, to be competitive with outside contractors or providers, a government's proposed in-house costs were based on a change in the delivery method for its solid waste collection service. This proposed change involved increasing the frequency of residential solid waste pickup from once a week to twice a week. If the decision were made to retain the solid waste collection service in-house, the implementation of this change in service should be addressed. In addition, any changes in the organizational structure proposed should also be implemented.

Awarding the Contract to an Outside Contractor or Provider

If the decision involves a change in service delivery to an outside contractor or provider, the customers or service recipients and any other interested parties should be notified. Such notification should address the nature of the changes, their impact on the affected parties, the effective date, and a contact individual for questions or comments. In addition, the support of the government or not-for-profit officials, including affected department heads, should be garnered to ensure all parties are working toward successful transition.

Writing the Recommendation Report

A written report from the competition task team to the evaluation committee communicates the background of the project, results of the planning and studies, and the final recommendation about the action to be taken regarding the target function or activity.

The recommendation report should address the following:

- The background of the competition project
- A summary of the tasks performed by the competition task team
- The results of the planning and studies
- The results of the cost analysis and the financial impact of the recommendation
- The recommendation about the service provider and any recommended action needed, such as the authority to finalize a contract

(Exhibit 5.1 is an example report from a competition task team to an evaluation committee of a city government recommending outsourcing its information technology function to an outside provider.)

Developing a Contract

An outsourcing effort will likely be unsuccessful without a well-written and comprehensive contract. Both the contracting entity and the contractor or provider must clearly understand the service to be provided and the performance expectations. The contract becomes the key document that enables the implementation of the performance monitoring plan.

An important aspect of contract development is the involvement of the government or not-for-profit organization's procurement or purchasing office or official. These individuals are experienced and familiar with the contracting requirements and can serve as excellent technical advisers in this contracting process.

In developing a good contract, the following considerations should be made:

- The contract should clearly distinguish the responsibilities of the contractor or provider from those of the contracting entity.
- The contracted services should be spelled out specifically and not in general terms.
- The contract should include clearly understood and measurable performance measures to ensure sufficient performance monitoring can be accomplished. The contract should reflect the results of the performance monitoring plan (see chapter 3).
- The contract should address the impact on the contractor of the transition logistics plan and personnel plan, such as transfer of assets and transfer of employees (see chapter 3).
- The contract should provide for specific actions that will be taken to obtain desired level of performance by the contractor or provider, such as incentive payments or sanctions.
- The contract should provide for a contingency plan that can be implemented in the case of contractor or provider nonperformance. Specific provisions for canceling the contract should be included.
- Finally, the contract should be reviewed and approved by interested in-house parties, including the purchasing office, legal department, affected department heads, and other key management.

The failure to consider and address these issues in the service contract could be the difference between a successful competition project and a complete failure.

Example. A state agency outsourced its turnpike maintenance activities to an outside contractor. However, the contractor had limited experience in highway or turnpike maintenance and was unable to secure necessary equipment. As a result, the quality of the roadways began to deteriorate during the contract period and a number of driver complaints were received. The contract did not include clear and measurable performance requirements and sanctions for poor performance. As a result of these contract deficiencies, the state agency had no leverage to force the contractor to improve performance. At the end of the contract period, the state agency selected a new outside provider and expanded the contract to include performance measurements and financial sanctions.

(Exhibit 5.2 is an example contract/agreement for outsourcing a city government's information technology function.) The success of the contracting project will be determined substantially from the strength of the written contract and the monitoring of that contract.

IMPLEMENTING THE PLANS

Whether the decision is to award a contract to an outside contractor or provider or retain the target function or activity in-house, certain aspects of the previously created plans (see chapter 3) will require implementation at this time. In the event the award is to a new outside provider, all the plans created will require implementation in order to make a smooth transition of both the service and personnel. In the event the target function or activity is retained in-house, the transition logistics and personnel plans will not be implemented; however, the performance monitoring plan will still be applicable.

Implementing the Transition Logistics Plan

As previously discussed, the primary objective of the transition logistics plan is to make the change to the new provider as transparent as possible to the service recipients. When implementing the transition logistics plan, the transfer of service issues must be included in the contract and implemented (see chapter 3).

Example. A not-for-profit museum is signing a contract with an outside provider to operate its gift shop. As decided in the museum's transition logistics plan, provisions were made in the contract for the following:

- Transfer of title of the gift shop capital assets, including cash registers, computer equipment, and shelving units
- Lease arrangements for the gift shop space
- Valuation and sale of current gift shop inventory to the new provider

The museum management determined that the contract monitoring could be performed with existing employees and equipment and that no formal public notification of a change in gift shop management was necessary.

Any costs associated with implementing the transition logistics plan, such as payment for new capital assets required or penalties for early cancellation of leases, were included in preparing the cost analysis (see chapter 4). The transition tasks and the financing of such costs must now be undertaken as part of the implementation of the plan.

Implementing the Personnel Plan

The personnel plan's primary objective is to accomplish any changes in the least disruptive manner for employees. This means making the most appropriate decision for the entity while being as fair as possible to all personnel involved.

When changes in personnel are planned, the entity has a number of options to consider (see chapter 3). These options, which were considered in the development of the personnel plan, should now be implemented.

> **Example.** A school district is outsourcing its bus service to an outside transportation company. Consistent with the district's personnel plan and the selected provider's response to the RFP, the outside provider has agreed, in the written contract, to hire all of the district's current drivers who will agree to become full-time employees of the company. The district has determined that there are no other school functions to which the other nonhired drivers can be transferred. As a result, the school district has agreed to a severance package of compensation for any displaced drivers, and the driver positions will be eliminated.

Any costs associated with implementing the personnel plan, such as payment of accrued compensated absences, post-employment benefits, and severance pay were included in preparing the cost analysis (see chapter 4). The personnel actions needed for displaced or transferred employees must now be implemented, and the financing of such costs must now be provided.

Implementing the Performance Monitoring Plan

Implementing the performance monitoring plan is critical to the continued successful operation of the target function or activity (see chapter 3). The government or not-for-profit organization will still be required to provide what its service recipients have paid for, whether through its own service delivery or a new contractor or provider. Monitoring enables the entity to measure how well it is meeting its service recipients' expectations. Monitoring also requires the entity to interact with the selected contractor or provider and service recipients and enables timely corrective action when necessary. Now the various forms of monitoring included in the performance monitoring plan (see chapter 3) should be implemented. The timing of contractor monitoring is a matter of professional judgment and available resources, and could include some form of daily, weekly, monthly, quarterly, or annual monitoring. Table 5.1 includes elements of an example performance monitoring program.

TABLE 5.1 ELEMENTS OF A PERFORMANCE MONITORING PROGRAM

Cost analysis	Have there been problems with cost overruns with the current provider? If so, what corrective actions have been taken? Have any anticipated cost savings been achieved? In what areas might additional cost savings be achieved?
Compliance analysis	Have contractor invoices been submitted in accordance with contract requirements? If federal or state awards are involved, have applicable compliance requirements been met?
Performance analysis	Is the service provider meeting the performance targets specified in the performance monitoring plan? Are there any known problems with the provider's performance? If so, what corrective actions have been taken? Has performance generally improved since the new provider was selected? In what areas might there be some potential or further performance improvements?
Overall analysis	Considering the above questions, how satisfactory has the provider's overall performance been? Should the target function or activity continue to be opened to competition? Should a new provider be considered, or the current provider retained? If the current provider should be retained, are there any contract changes needed?

All personnel actions, such as the hiring of new monitoring staff, associated with implementing the performance monitoring plan, and all of the related monitoring costs were included in preparing the cost analysis (see chapter 4). The performance monitoring plan actions needed and the financing of such costs must now be implemented.

CONCLUSION

The selection of the most appropriate service provider involves a formal process by an evaluation committee that considers the recommendation report prepared by the competition task team that addresses a number of selection criteria, including the results of the qualitative analysis, the performance monitoring plan, the transition logistics plan, the personnel plan, the cost analysis, and the various advantages and disadvantages of the selection alternatives.

If the decision involves selecting a new outside contractor or provider, a complete and comprehensive contract is essential to the ultimate success of the project. The contract must facilitate the monitoring of contractor or provider performance and remedies for nonperformance. If the decision involves retaining the service in-house, any proposed changes in service delivery and the performance monitoring plan should be implemented.

Finally, regardless of whether the target function or activity's services continues to be provided in-house or is delivered by a new outside provider, performance monitoring must be performed to help ensure the service is provided effectively and efficiently and desired performance levels are achieved.

The CPA can play an important role in the provider selection and implementation process, including assisting the competition task team in writing the recommendation report, providing professional advice to the evaluation committee, assisting in the development of written contracts, and performing monitoring and audit services.

Exhibit 5.1

Sample Recommendation Report to Evaluation Committee

This illustration material is intended as a sample only. It is included with the understanding that the publisher, author, contributors, and editors are not rendering legal or other professional services. Practitioners are advised to consult legal counsel for specific advice on the appropriateness of this material for their own use.

A written report from the competition task team to the evaluation committee communicates the background of the project, results of the planning and studies, and the final recommendation about the action to be taken regarding the target function or activity.

The example recommendation report presented here addresses the following:

- The background of the project
- A summary of the tasks performed by the competition task team
- The results of the planning and studies
- The financial impact of the recommendation
- The recommended action

TO: Evaluation Committee

FROM: Competition Task Team

DATE: XX-XX-20XX

RE: Information Technology Outsourcing

Background: City staff has been working to outsource the city's Data Processing and Telecommunications functions since the spring of 20X0. Council redirected resources in the fiscal year X0-X1 budget to provide an increased level of information technology services.

Tasks Performed: The following is a chronological listing of the process:

- Spring 20X0
  —Through the completion of a qualitative analysis of competition potential, the City determined the need to seek an information technology business partner.
  —A multidepartmental team, working with the guidance of an outside consultant, developed a request for proposals (RFP) for Data Processing and Telecommunications Outsourcing Services.
  —The RFP was distributed to 25 known outsourcing providers across the nation.
  —The City conducted a question and answer session for vendors, and approximately twenty companies were represented.
  —The City received seven responses to the RFP.
- Summer 20X0
  —The Competition Task Team used criteria outlined in the RFP to rank the companies, and four emerged as potential providers.
  —Reference checks were conducted of these four potential providers.
  —The Competition Task Team met with the Council Finance Committee to discuss the four vendors and the valuable information that had been gained through reference checks.
  —Two finalists were recommended for consideration by the competition task team: Active Business Corporation (ABC) and Dynamic Computer Technology (DCT).
  —Site visits to company sites were conducted.
- Fall 20X0
  —Both companies made final presentations to the Council Finance Committee, the Evaluation Committee, department directors, and data processing employees.

Exhibit 5.1 *(continued)*

—The Evaluation Committee met to review and consider all elements of the total process: the transition logistics plan, personnel plan, performance monitoring plan, proposal responses, reference checks, site visits, due diligence reviews, vendor follow-up, presentations and feedback obtained from the Council Finance Committee, the management team, various city staff, and the data processing employees.

—ABC distinguished itself through its consistent responsiveness and its business model for planning strategically with a customized approach to meet our unique needs and deliver value added technology solutions.

—A cost analysis was performed, comparing the relevant costs of retaining the service delivery in-house to the costs proposed by ABC. Although cost savings through outsourcing would be insignificant, the recommendation was to negotiate a contract with ABC to improve performance.

—The City Council authorized the City Manager to enter into contract negotiations with ABC for the on-site management of Data Processing and Telecommunications.

—ABC and the City began and completed formal contract negotiations. The Council Finance Committee and staff met to discuss the final version of the contract.

Results and Financial Impact: Management, with council support, designed new budgeting initiatives to shift existing resources to provide an increased emphasis on Information & Technology in the fiscal year X0-X1 budget. The Agreement will provide contract services from budgeted funds to achieve council and organizational goals. The fiscal year X0-X1 monthly payments for this contract totals $xxxx. The $xx million Information & Technology operating budget and existing funds in the Information & Technology capital budget will fund this expenditure.

The proposed contract is for a five-year term for a total amount of $xxxx. There is a clause within the contract that provides that if funds are not appropriated for these services, the City may cancel the agreement without penalty.

Recommendation: Receive report and authorize an agenda item for approval of the agreement for the next council meeting.

Attachments: Highlights of the Proposed ABC—City Agreement

Exhibit 5.1 *(continued)*

Highlights of the Proposed Agreement

The City has negotiated a performance-based Agreement with payments tied to defective performance. City staff has worked with ABC to develop an Agreement that reflects the City's Information & Technology facilities and management needs. Highlights of the proposed Agreement are as follows:

I. Standard Vendor Services

- Vendor will prepare a Technology Strategic Plan with annual updates.
- Citizen access to city services will be enhanced through the Web page.
- Vendor will prepare a Disaster Recovery Plan.
- Vendor will prepare a Telecommunications Assessment.
- Vendor will perform on-site daily management of data processing and telecommunications.
- Vendor will assist in the implementation of a help desk.
- Vendor will maintain an on-site training center.

II. Measures of Performance

The proposed Agreement requires ABC to meet specified performance indicators, such as the following:

- System availability
- Scheduled services
- Requests for service

If ABC is defective in its performance over a specified period of time, the City will receive a credit to its monthly fees for that particular defect.

(See Section 5.2 of the Agreement)

III. Project List for 20XX

- Implement city-wide network to enhance communications with citizens and increase efficiencies in daily operations.
- Buy and install 300 PCs with MS Office.
- Install an uninterruptable power supply for disaster recovery purposes.

IV. Monthly Fee

This Agreement proposes that the City pay ABC $xxxx for the remainder of fiscal year X0-X1, an amount equal to $xxxx per month for the first 12 months of the contract.

V. Term

The proposed Agreement is for five years in duration, with the option to renew. The City does have the right to terminate for convenience upon the first anniversary date of the effective date of the contract.

VI. Additional Resources

Currently, Information Technology has 5 employees, 2 contract employees (1 part-time), and 3 vacant positions. ABC proposes to add more positions, to bring the staff size to 17 total positions. ABC has also agreed to transition the 5 current employees to its employment.

Exhibit 5.1 *(continued)*

VII. Items Excluded From Service

- Public Safety software and 911 telephone systems software and XYZ hardware
- Library hardware and software maintenance with EFG Inc. and HIJ services
- Traffic control microwave system and field controllers, signals, and video equipment
- Radio operations and equipment
- Video security systems; fire and security alarm panels
- Copy machines, fax machines, and micromedia readers and printers

VIII. Other Aspects of the Agreement

- ABC will provide monthly management reports on performance indicators, system use, and help desk.
- ABC will provide an on-site trainer to instruct staff on desktop, network, and telecommunications applications and equipment.

Exhibit 5.2

Sample Contract/Agreement With a Service Provider

This illustration material is intended as a sample only. It is included with the understanding that the publisher, author, contributors, and editors are not rendering legal or other professional services. Practitioners are advised to consult legal counsel for specific advice on the appropriateness of this material for their own use. Certain exhibits have been included for illustration purposes; others are not included due to their commonplace nature.

The development of a well-written and comprehensive contract or agreement with a selected service provider is essential for a successful competition project. Both the contracting entity and the contractor must clearly understand the service to be provided and the performance expectations. The contract becomes the key document that enables the implementation of the performance measurement plan. In developing a good contract, the following considerations should be made:

- The contract should clearly distinguish the responsibilities of the contractor from those of the contracting entity.
- The contracted services should be spelled out specifically and not in general terms.
- The contract should provide for specific actions that will be taken to obtain desired level of performance by the contractor.
- Contract developers should include clearly understood and measurable performance measures to ensure sufficient performance monitoring can be accomplished.
- Contract developers should address the impact on the contractor of the transfer logistics plan and personnel plan, such as transfer of assets and transfer of employees.
- Contract developers should establish a contingency plan that can be implemented in the case of contractor nonperformance and include specific provisions for canceling the contract.

Agreement for Information Technology Services

This agreement (the Agreement) is made on the __ day of _________, 20XX by and between the City of Example, Any State (the Client or City), a municipal corporation of Any County, Any State, and Active Business Corporation (the Vendor or ABC), an Any State corporation with its principal place of business at 1111 West Example Lane, Suite 400, City of Example, Any State XXXXX-XXXX.

Recitals

A. City currently operates an internal Information and Technology (IT) Services Department consisting of Data Processing and Communications Divisions.

B. ABC is in the IT outsourcing business.

C. City and ABC intend that City shall transfer its current IT operations to ABC in a facilities management outsourcing relationship, and that ABC shall provide to City all of the services described in Exhibit B (see attached).

Now therefore, the parties mutually agree as follows.

Article One—Definitions

1.1 The definitions listed on Exhibit A (see attached) shall be used in interpreting this Agreement.

Article Two—Services

2.1 **DESCRIPTION OF VENDOR SERVICES.** With the exception of the Excluded Services, as set forth in Exhibit B (see attached), ABC agrees to perform the following services (collectively, the Vendor Services):

Exhibit 5.2 *(continued)*

A. All the services provided by City's IT Department prior to the Effective Date, and all new services that the City and ABC have agreed upon (collectively, the Standard Vendor Services).

B. Those services specified in Exhibit B (see attached) under the heading "Projects."

C. Those services specified in Exhibit B (see attached) under the heading "Outstanding Service Requests."

2.2 **SUPPLEMENTAL SERVICES.** ABC shall perform all services requested by City that are not Vendor Services (the Supplemental Services).

A. City shall not pay ABC for Supplemental Services except in accordance with the following:

(1) City requests Supplemental Services in writing;

(2) ABC gives City a written estimate of the total cost of performing the Supplemental Services (the Task Estimate); and

(3) City gives ABC written authorization to perform the Supplemental Services.

B. ABC shall maintain time and expense records for all time and moneys expended on any Supplemental Service, and provide City with a copy of such records relating to such Supplemental Service.

Article Three—Fees

3.1 For the Vendor Services, City shall pay ABC a fixed fee per month in advance (Vendor Fees), as described in Exhibit C [*not included in this publication*].

3.2 **PAYMENT DUE DATES.** Fees shall be due and payable on the first day of each month beginning January 1, 20XX, and continuing every month thereafter. Fractional months shall be prorated. Payment for Supplemental Services shall be invoiced monthly and due thirty (30) days from the receipt of invoice. Balances past due on undisputed amounts in excess of forty-five (45) days from date of invoice shall bear overdue service charges at one and one-half percent ($1^1/_2$%) per month or the highest rate permitted by law, whichever is less.

3.3 **MODIFICATIONS OF VENDOR SERVICES, PERFORMANCE INDICATORS, AND VENDOR FEES.** City shall have the right to propose reductions in Vendor Services, Performance Indicators, and Vendor Fees at any time during this Agreement due to significant financial adversity. ABC cannot unreasonably withhold agreement to such reductions.

Article Four—Start-Up Transition

4.1 **SCHEDULE OF EVENTS.** ABC and City agree to perform their respective obligations in accordance with Schedule of Events below. The Schedule of Events can be modified only with the written consent of both parties.

Twelve-Month Transition Period—Schedule of Events

The City of Example and ABC agree to the implementation of a measurable first Twelve (12) Month Transition Plan. The plan's objectives are to stabilize the environment, develop a long-range strategic plan, reduce outstanding service requests, implement a City-wide network, install new PCs, develop an on-site training center, implement a help desk, develop a disaster recovery plan, evaluate the telecommunications system, upgrade the mainframe, install an uninteruptable power supply, and implement a call accounting system.

Exhibit 5.2 *(continued)*

4.2 **LIAISONS.** ABC and City hereby agree that the following individuals shall serve as their respective liaisons. The liaisons shall serve as a point of contact by which the parties may communicate on a frequent basis. Either party may change its liaison upon written notice to the other party.

A. "Vendor Liaison" shall be John Doe, Account Manager.

B. "Client Liaison" shall be Jane Smith, IT Team Leader.

4.3 **EXISTING INFORMATION AND TECHNOLOGY SERVICES EMPLOYEES.** Exhibit E [*not included in this publication*] is a list of all of City's current Information and Technology Services employees (the IT Employees). ABC expressly agrees to offer employment to those IT Employees listed on Exhibit E [*not included in this publication*] in the same or comparable job categories as such IT Employees have with City, for a minimum of one year after the effective date of this Agreement and in accordance with this Section.

A. ABC agrees to offer the IT Employees employment with ABC at total compensation packages (including base salary and benefits but not temporary assignment pay) equal or comparable to their salary and benefits as of December 4, 20XX.

B. During the first year following the effective date of this Agreement (the Guaranteed Period), ABC may terminate an IT Employee only for cause.

C. After the Guaranteed Period, ABC may terminate any IT Employee in accordance with ABC's existing personnel policies.

4.4 **EXISTING SOFTWARE LICENSES.** ABC understands that City's existing IT system includes software of third-party vendors, subject to licensing or similar agreements between the City and such third-party vendors. A list of those existing agreements is set forth in Exhibit F [*not included in this publication*]. ABC shall use reasonable efforts to act on City's behalf with respect to such third-party vendors. City shall, as soon as is practical, deliver copies of such agreements to ABC. City's status as a Licensee on all agreements listed in Exhibit F [*not included in this publication*] shall be maintained during the term of this Agreement.

Article Five—Performance Indicators

5.1 **PERFORMANCE INDICATORS.** "Performance Indicators" means the measures specified in Exhibit G (see attached). Failure to perform in accordance with the Performance Indicators is "Defective Performance."

5.2 **REMEDIES FOR DEFECTIVE PERFORMANCE.** In addition to such other remedies as are available to City, if there is a Defective Performance, City may avail itself of the remedies specified in this Section. However, once a remedy in the form of a credit against Vendor Fees has been recovered by City for any Defect, that Defect giving rise to that credit shall not give rise to any other remedy based on any type of liquidated damages.

A. Types of Defective Performance are defined as follows:

1. A "Defect" is any Defective Performance. However, events totally beyond the control of ABC that do not arise from the negligence or intentional misconduct of ABC or any of its agents or employees shall not count as Defects.

2. A "System Availability Defect" is a Defect arising from ABC's failure to meet a Performance Indicator set forth in Exhibit G (see attached) under the listing, "Systems Availability: Workstations." Scheduled downtime previously approved in writing by the Client Liaison is not a System Availability Defect.

Exhibit 5.2 *(continued)*

3. A "Production Defect" is a Defect arising from ABC's failure to meet a Performance Indicator set forth in Exhibit G (see attached) under the listing, "Services," that requires on-time production of any of the following items:

   a. Payroll

   b. Utility bills

   c. Tax notices

   d. Periodic reports

B. Following two System Availability Defects in two consecutive months (as defined in the attached Exhibit G), ABC shall grant City a credit of XXXX dollars ($XXXX) against the Vendor Fees for each succeeding System Availability Defect.

C. Following one Production Defect arising out of the late production of City's tax notices in any two consecutive year period, ABC shall grant City a credit of XXXX dollars ($XXXX) against the Vendor Fees for each succeeding Production Defect arising out of the late production of City's tax notices occurring in the same two-year period.

D. Following two consecutive Production Defects arising out of the late production of City's utility bills, ABC shall grant City a credit of XXXX dollars ($XXXX) against the Vendor Fees for each succeeding Production Defect arising out of the late production of City's utility bills.

E. ABC shall grant City a credit of XXXX dollars ($XXXX) against the Vendor Fees for each Production Defect arising out of the late production of City's payroll.

5.3 **CORRECTION OF PROCESSING ERRORS.** In addition to such other remedies as may be available to City, ABC shall, at its own expense, promptly correct errors that occur in providing the Vendor Services.

Article Six—Disputes and Resolution of Problems in Performance

6.1 **DISPUTE RESOLUTION AND ESCALATION PROCEDURES.** All disputes between ABC and City shall adhere to the following procedures prior to the commencement of any mediation pursuant to the provision titled **"NON-BINDING MEDIATION"** or any judicial proceedings.

A. The Liaison shall notify the other party's Liaison in writing of the occurrence of a dispute and shall establish a mutually convenient time and place to meet in order to discuss such dispute. In any event, such meeting shall occur within forty-eight (48) hours of the time of the Liaison's notice to the other Liaison.

B. If the Liaisons cannot resolve the dispute to the satisfaction of both parties within twenty-four (24) hours of their first meeting, then either Liaison may give written notice of the inability to resolve such dispute to the Designated Executive, designated below, of the other party. The Designated Executives of both parties shall meet within 48 hours of such written notice at a mutually convenient time and place.

C. If after one week the Designated Executives have not resolved the dispute to their satisfaction as agreed in writing, then either party may proceed in accordance with its remedies stated elsewhere in this Agreement, or as provided by law.

D. The Designated Executives are:

   (1) Client-Designated Executive: Assistant City Manager

   (2) Vendor-Designated Executive: Vice President

Exhibit 5.2 *(continued)*

6.2 **NON-BINDING MEDIATION.** If ABC and City do not agree in writing that they have resolved a dispute, then after expiration of the periods referred to in the Section titled **"DISPUTE RESOLUTION AND ESCALATION PROCEDURES,"** either City or ABC may by written notice to the other (a Mediation Notice) invoke the provisions of this Section.

A. Upon receipt of a Mediation Notice, City and ABC shall submit to non-binding mediation within ten (10) days.

B. The mediator shall be mutually agreed upon in writing.

C. Each party shall bear its own costs and one-half of the mediator's fees, if any.

D. If ABC and City cannot agree on a mediator within ten (10) days of receipt of Mediation Notice, they shall use the mediator selected by the president of the State Bar Association.

6.3 **CONTINUITY DURING DISPUTE.** In the event there is a dispute between City and ABC, ABC shall continue to perform Vendor Services so long as the City pays at least fifty percent (50%) of any amount in controversy up to XXXX dollars ($XXXX), and eighty percent (80%) of any amount in controversy that exceeds that amount.

Article Seven—Warranties, Indemnification, and Limitations of Liability

7.1 **VENDOR'S WARRANTIES.** ABC represents and warrants the following:

A. That ABC is entitled to enter into this Agreement and that by entering into this Agreement it does not and shall not violate any other Agreement to which ABC is a party;

B. That ABC is a corporation, duly organized, validly existing, and in good standing under the laws of the State of Delaware;

C. That ABC has performed all necessary corporate action to have the appropriate authority to enter into this Agreement and comply with its provisions;

D. That ABC shall perform in accordance with the Performance Indicators;

E. That ABC's employees and agents shall perform their duties in a skillful and workmanlike manner; and

F. That none of the insurance required or provided for in this Agreement excludes coverage for liability created by contract.

7.2 **INDEMNIFICATION.** ABC agrees to indemnify, defend, and hold harmless the City from any and all damages, liabilities, costs, and expenses, including reasonable attorneys' fees and expenses, arising out of, under, on in connection with any claim, demand, charge, action, cause of action, or other proceeding:

A. Arising out of or resulting from (1) the death of or bodily injury to any person or (2) the damage to, or loss or destruction of, any tangible property, to the extent caused by the acts or omissions of ABC;

B. Resulting from an act or omission of ABC in its capacity as an employer of a person or persons arising out of or related to (1) federal, state, or other laws or regulations for the protection of persons who are members of a protected class or category of persons, (2) sexual discrimination or harassment, (3) work related injury or death, (4) accrued employee benefits not expressly assumed by the indemnity, and (5) any other aspect of the employment relationship or its termination (including claims for breach of an express or implied contract of employment) and which, in all such cases, arose after the effective date and when the person asserting the claim, demand, charge, action, cause of action, or other proceeding, was or purported to be an IT employee or an employee of ABC.

Exhibit 5.2 *(continued)*

7.3 **LIMITATIONS OF LIABILITY.** City and ABC agree that this Agreement is subject to the following disclaimers and limitations of liability:

A. Except for the express warranties described in the Section titled **"VENDOR'S WARRANTIES,"** neither ABC nor City makes any other warranties, express or implied, including without limitation the implied warranties of merchantability and fitness for a particular purpose.

B. In no event shall a cause of action be asserted by one party against the other party more than two years after such cause of action accrued.

C. Except for any damages arising from personal injuries or death to the extent caused by ABC'S negligence for which ABC is obligated to indemnify City under Section 7.2, above, neither party shall be liable to the other for any indirect, incidental, or consequential damages arising out of the performance of this agreement.

D. Neither party shall be liable to the other for any reason whatsoever in an amount exceeding the limits of insurance provided for or required by this agreement plus XXXX dollars ($XXXX) with the following exceptions:

- Vendor fees;
- Amounts expressly due and payable to either party; and
- Any amounts due to city from ABC pursuant to the indemnity provisions of Section 7.2, above.

E. The three hundred thousand dollar ($300,000) limit of liability provided for in Section 7.3D, above, shall be in the aggregate for any and all claims arising from or related to this agreement.

Article Eight—Term and Termination

8.1 **TERM.** This Agreement is effective upon January 1, 20XX (the Effective Date) and shall remain in effect for five (5) years (the Agreement Term).

8.2 **EXPIRATION.** Upon the end of the Agreement Term, ABC and City shall proceed in accordance with the Section titled **"PROCEDURES UPON EXPIRATION OR TERMINATION."**

8.3 **RENEWAL.** City and ABC may mutually agree to renew this Agreement for an additional term of five (5) years on one hundred and eighty (180) days' notice prior to the end of the then current term.

8.4 **TERMINATION FOR BREACH.** If either party breaches this Agreement and fails to remedy such breach after exhaustion of the procedures outlined in Article Six of this Agreement, the non-breaching party may terminate this Agreement. Upon such termination, the parties shall proceed in accordance with the Section titled **"PROCEDURES UPON EXPIRATION OR TERMINATION."**

8.5 **TERMINATION FOR LACK OF APPROPRIATED FUNDS.** ABC agrees that, should the City Council governing City fail to appropriate sufficient funds to make the payments due pursuant to this Agreement, City will immediately notify ABC of such occurrence, and ABC may either (a) reduce its staffing and level of services to the amount appropriated and budgeted or (b) notify City that this Agreement will terminate following the period for which funds have been appropriated and budgeted. Such termination shall be without charge or penalty to City, provided, however, that City does not contract with or hire any third-party to provide similar Vendor Services for a period of at least sixty (60) days after termination under this provision. Upon such termination, ABC and City shall proceed in accordance with the Section titled **"PROCEDURES UPON EXPIRATION OR TERMINATION."**

Exhibit 5.2 *(continued)*

8.6 **TERMINATION FOR INSOLVENCY.** Subject to the provisions of Title 11, United States Code, if ABC becomes or is declared insolvent or bankrupt, is the subject of any proceedings relating to its liquidation, insolvency, or for the appointment of a receiver or similar officer for it, makes an assignment for the benefit of all or substantially all of its creditors, or enters into an agreement for the composition, extension, or readjustment of all or substantially all of its obligations, then City, by giving written notice, may terminate this Agreement as of a date specified in such notice of termination without cost or penalty in accordance with the Section titled **"PROCEDURES UPON EXPIRATION OR TERMINATION."**

8.7 **CHANGE IN CONTROL.** ABC shall notify the City, in writing, in the event a third-party acquires a substantial majority of the assets and/or stock of ABC during the term of this Agreement. The City shall have the right to terminate this Agreement without cost or penalty for forty-five (45) days after receipt of this notice. If the City does not exercise its right to terminate within forty-five (45) days, the Agreement shall continue in full force and effect for the remaining term of this Agreement. Upon such termination, ABC and City shall proceed in accordance with the Section titled **"PROCEDURES UPON EXPIRATION OR TERMINATION."**

8.8 **PROCEDURES UPON EXPIRATION OR TERMINATION.** If this Agreement expires or is terminated, then City and ABC shall proceed in accordance with this Section.

A. The date this Agreement expires is the "Expiration Date."

B. If this Agreement is terminated, the date on which termination is effective is the "Termination Date."

C. City either may immediately cease using the Vendor Services or, in the City's sole discretion, City may proceed in accordance with the provisions of the Section of this Agreement titled **"TURNBACK."**

D. City shall give ABC express written notice of the election that City chooses in accordance with the following, as relevant:

(1) At least one hundred and eighty (180) days prior to the expiration of the Agreement Term;

(2) At least one hundred and twenty (120) days after giving ABC notice that City may terminate for breach;

(3) Within one hundred and eighty (180) days after receiving ABC's notice that ABC may terminate for breach;

(4) At least one (1) month prior to termination pursuant to the Section titled **"TERMINATION FOR LACK OF APPROPRIATED FUNDS."**

(5) At least one (1) month prior to termination pursuant to the Section titled **"TERMINATION FOR INSOLVENCY"** or **"CHANGE IN CONTROL."**

8.9 **TURNBACK.** If City elects to proceed in accordance with this Section and pursuant to the Section titled **"PROCEDURES UPON EXPIRATION OR TERMINATION,"** then ABC, in accordance with this Section, shall continue to provide the Vendor Services and charge the Vendor Fees for up to nine (9) months after the Termination Date or Expiration Date, as relevant (the Turnback Period).

A. ABC may cease providing the Vendor Services after expiration of the Turnback Period.

B. During the Turnback Period, City may terminate the Vendor Services upon thirty (30) days' notice.

Exhibit 5.2 *(continued)*

C. At no additional charge, ABC shall provide City with the following services in addition to the Vendor Services (the Turnback Services).

(1) ABC shall promptly answer City's inquiries concerning the Vendor Services.

(2) ABC shall coordinate the orderly transfer of communications to City's facilities as designated in writing by the City.

D. At no additional charge, ABC shall provide City with the following items (the Turnback Deliverables):

(1) A copy of City's data and City's software:

a. On magnetic media specified by City; and/or

b. Electronically transmitted to City's facilities in accordance with City's written instructions.

(2) A copy of all runtime documentation that ABC has for the City's software.

(3) A copy of all job control that ABC has for the City's software.

(4) A written description and graphic of the network topology for the City server network used to provide the Vendor Services.

(5) A written inventory and copies of all of City's third-party software and documentation, including City's licenses.

(6) A written inventory of all of ABC's own software and documentation used to provide the Vendor Services (Vendor Software), including City's licenses.

E. ABC shall provide the Turnback Deliverables within thirty (30) days after a written request by City, but in any event prior to the expiration of the Turnback Period.

F. During the Turnback Period, ABC shall offer to sell to City, as provided by law, any hardware acquired by ABC pursuant to this Agreement at a price not to exceed the book value of the hardware minus depreciation.

8.10 **CONTINUING RIGHTS TO USE CERTAIN SOFTWARE.** ABC and City hereby agree that upon expiration or termination of this Agreement, City has the option to use the software specified in this Section and listed in Exhibit F [*not included in this publication*] in accordance with the provisions of this Section.

A. City's option is exercisable upon written notice to ABC prior to the Termination Date or Expiration Date.

B. Upon exercising the option, City may use the Vendor Software, the software listed in Exhibit F [*not included in this publication*], and all associated documentation as a Licensee.

C. City shall use the Vendor Software in accordance with ABC's license agreement(s).

D. Upon receipt of the notice and license fees due ABC, if any, ABC shall provide City with a copy of the Vendor Software in source and object code format on the magnetic media specified in writing by City.

Article Nine—Insurance

9.1 ABC shall, during the Agreement Term, have and maintain in force the following insurance coverages:

A. Worker's Compensation Insurance with the limits prescribed by Any State statute.

Exhibit 5.2 *(continued)*

B. Commercial General Liability Insurance, including Products, Completed Operations Liability and Personal Injury, Contractual Liability, and Broad Form Property Damage liability coverage for damages to any property with a minimum combined single limit of $XXXX per occurrence. This policy shall be endorsed to name the City as additional insured.

C. Electronic Data Processing (EDP) All Risk Property Insurance on equipment, data, media, software, telephone system, and valuable papers, including extra expense coverage, business interruption and recovery, with a minimum limit of XXXX dollars ($XXXX) adequate to cover such risks on a replacement and/or functional costs basis.

D. Automotive Liability Insurance covering use of all owned, non-owned, and hired automobiles with a minimum combined single limit of $XXXX per occurrence for bodily injury and property damage liability. This policy shall be endorsed to name the City as additional insured.

E. Umbrella Liability Insurance with a minimum limit of $XXXX in excess of the insurance under policies indicated in Subsections A, B, and D, above, and Subsection G, below.

F. Employee Dishonesty and Computer Fraud coverage for loss arising out of or in connection with any fraudulent or dishonest acts committed by the employees of Vendor, acting alone or in collusion with others, including the property, data, and funds of others in their care, custody, or control, in a minimum amount of $XXXX.

G. Errors and Omissions Liability Insurance covering the liability for financial loss due to error, omission, negligence of employees, and machine malfunction and software incompatibility in an amount of at least $XXXX.

The foregoing insurance coverages shall be primary and non-contributing with respect to any other insurance or self-insurance that may be maintained by the City. ABC shall cause its insurers to issue certificates of insurance evidencing that the coverages and policy endorsements required under this Agreement are maintained in force and that not less than ninety (90) days' written notice shall be given to the City prior to any modification, cancellation, or non-renewal of the policies. The insurers selected by ABC shall assure that its submitted subcontractors, if any, maintain insurance coverages as specified in this Section or are endorsed as additional insureds on all required ABC coverages.

9.2 **FAILURE TO COMPLY AS BREACH.** ABC understands that failure to timely comply with the requirements of this Article shall be cause for termination of this Agreement for breach pursuant to Section 8.4 of this Agreement.

Article Ten—Confidentiality, Security, and Audit Rights

10.1 **CONFIDENTIAL INFORMATION.** ABC and City expressly agree that all information communicated to ABC with respect to this Agreement and with respect to the services provided by ABC pursuant to this Agreement, including, without limitation, any confidential information obtained by ABC by reason of its association with City, is confidential. ABC further agrees that all information, conclusions, reports, designs, plans, project evaluations, data, advice, business plans, and/or other documents available to ABC pursuant to this Agreement are confidential and proprietary property of City. Except as otherwise provided by law, ABC and City agree that all proprietary and confidential information disclosed by the other during performance of this Agreement and identified in writing as proprietary or confidential shall be held in confidence and used only in performance of this Agreement. If such information is available by law, already in the disclosing party's possession or knowledge, or is thereafter rightfully obtained by the disclosing party from sources other than the other party, then there shall be no restriction in this disclosure. ABC shall protect all data of the City in accordance with the Public Information Act and all state and federal privacy laws.

Exhibit 5.2 *(continued)*

10.2 **SECURITY.** ABC will comply with the written security procedures that are in effect at City's location on the Effective Date. City will also institute such additional reasonable security procedures at City's location as ABC requests as a Supplemental Service.

10.3 **RIGHT TO AUDIT.** ABC agrees that City, at City's expense, may engage an independent firm (the Auditor) to audit ABC's records and operations relevant to this Agreement to determine ABC's compliance with this Agreement and any and all Supplemental Service agreements. City will not have access to ABC's financial, payroll, or benefits records unless such records are required to determine ABC's compliance with this Agreement. ABC will not be required to provide Auditor access to data of ABC's customers, other than City, or any proprietary information. Upon fourteen (14) days' written notice, the Auditor may enter ABC's premises and commence such audit. The Auditor shall use its best efforts to avoid disrupting ABC's business operations.

Article Eleven—Miscellaneous

11.1 **CITY AS REFERENCE SITE.** City agrees upon ABC's prior and reasonable request to act as a reference site for ABC in connection with the services provided under this Agreement, so long as such reference site visits do not tend to degrade performance of the Vendor Services. In this connection, City will, upon timely receipt of notice thereof, make its facilities and personnel reasonably available to ABC as reasonably requested by ABC to permit ABC to provide site visits to current and prospective clients and to demonstrate any or all of the services provided by ABC to City under this Agreement. City may unilaterally withdraw as a reference site in the event site visits become unduly burdensome and/or disruptive.

11.2 **SELECTION OF PERSONNEL.** City shall have the right to review and make recommendations regarding employees and agents of ABC assigned to perform the Vendor Services provided for in this Agreement, including but not limited to ABC's manager in charge of operations at City's site. ABC will not unreasonably disregard City's recommendations.

11.3 **NEW THIRD-PARTY SOFTWARE.** Prior to introducing any third-party software for the purpose of performing any of the Vendor Services on or after the effective date of this Agreement, ABC shall obtain a perpetual, non-exclusive license for such new third-party software in the name, and on behalf, of City at no extra charge to City, unless City has previously agreed in writing to waive this requirement. Any such license shall include a grant of rights for ABC to use such new third-party software for the benefit of City during the term of this Agreement. ABC will provide City with a reasonable opportunity to review and approve such license prior to its execution. With City's prior, written consent, ABC may introduce the third-party software for use in providing the Vendor Services. ABC shall have financial, operational, and administrative responsibility for such third-party software and related maintenance obligations during the term of this Agreement to the same extent as if ABC were the licensee of such third-party software. ABC shall comply with the duties, including use restrictions and those of nondisclosure, imposed on City by the license for such third-party software. Except as otherwise requested or approved by City (or the relevant licenser), or unless such use is authorized under a separate license agreement between ABC and the licenser of any third-party software, ABC shall cease all use of such third-party software upon expiration or termination of this Agreement.

11.4 **FACILITIES.** City agrees to make facilities (including space, office furnishings and fixtures, utilities, and telephones) available to ABC for the performance of the Vendor Services at no additional charge or fee to ABC. However, facilities (including copying and long-distance telephone service) shall not be used for personal reasons or for the performance of services for any of ABC's clients other than City, without City's prior written permission. ABC shall maintain the facilities in the same condition from the Effective Date until the Expiration Date or the Termination Date, ordinary wear and tear excepted. City will bear the cost of utilities, repairs to the facilities not caused by the negligence or intentional misconduct of ABC or any of its agents or employees, and installation or replacement of any air conditioning or other mechanical equipment reasonably required for the proper performance of the Vendor Services.

Exhibit 5.2 *(continued)*

11.5 **EXISTING HARDWARE AND SOFTWARE MAINTENANCE AND LEASE AGREEMENTS.** City agrees to assign to ABC or to terminate hardware and software maintenance and lease agreements specified in Exhibit F [*not included in this publication*] within sixty (60) days of the Effective Date. As of the Effective Date, ABC shall assume complete financial responsibility for such hardware maintenance agreements. If the assignments specified in this Section are not accomplished as of the Effective Date and City is obligated to make additional payments after the Effective Date, City may subtract such payments from all or any amounts due to ABC.

11.6 **ASSIGNMENT/SUBCONTRACT.** ABC may not assign or subcontract this Agreement without City's prior express written consent, which shall not unreasonably be withheld. Nothing in this provision shall prevent ABC from hiring individual subcontractors to assist in the performance of specific projects. All contractors and subcontractors used by ABC in the performance of the Vendor Services shall be bound by the terms and conditions of this Agreement, including but not limited to the confidentiality requirements of Section 10.1. ABC shall verify that all such contractors and subcontractors are adequately insured.

11.7 **GOVERNING LAW.** City and ABC agree that this Agreement shall be governed by the laws of the Any State without regard to the Any State's choice of law rules.

11.8 **FORCE MAJEURE.** Neither party shall be liable for any delay or failure to perform its obligations hereunder to the extent that such delay or failure is caused by a force or event beyond the control of such party, including without limitation, war, embargoes, strikes, governmental restrictions, riots, fires, floods, earthquakes, or other Acts of God (the Force Majeure); provided that ABC shall use reasonable commercial efforts to assist the City in establishing necessary Vendor Services elsewhere, in the event of the occurrences of a Force Majeure which—

A. Materially prevents ABC from providing any of the Vendor Services for more than ten (10) business days, and ABC has not successfully transferred the City's data processing to a backup facility under terms and conditions reasonably acceptable to the City; or

B. Causes the normal operations of the site to be interrupted for more than forty-five (45) days, and, in the City's reasonable business judgment, it is necessary to pursue alternative means of meeting the City's IT needs.

11.9 **NOTICE.** All notices and demands required to be given pursuant to this Agreement shall be given to the parties in writing and by certified mail, return receipt requested, at the addresses specified in this Section or to such other addresses as the parties may hereinafter substitute by written notice given in the manner prescribed by this Section.

A. **Notice to City**
City Manager
City of Example, Any State
P.O. Box XXXXXX
Example, Any State

with copy to:

City Attorney
City of Example
P.O. Box XXXXXX
Example, Any State

B. **Notice to ABC**
President, Active Business Corporation
XXXX Street South
Example, Any State

Exhibit 5.2 *(continued)*

11.10 **VENUE.** ABC and City expressly agree that this Agreement is entered into and performable in Example County, Any State, and that all, if any, suits arising under this Agreement shall be brought in courts located in that county, or, if in federal court, in the Northern District of Any State.

11.11 **INTEGRATION OF AGREEMENT.** ABC and City agree that this Agreement and the Exhibits hereto, as well as City's Data Processing and Telecommunication Outsourcing RFP dated April XX, 20XX (the RFP) and ABC's response to the RFP (the Response) embody the entire agreement of ABC and City in relation to the subject matter herein and that there are no other oral or written agreements or understandings between ABC and City at the time of the execution of this Agreement.

11.12 **CONTROLLING DOCUMENT.** If there is a conflict between the Agreement, an Exhibit, and/or the Response, then such conflicts shall be resolved as follows:

A. If there is a conflict between the Agreement and an Exhibit, then the Agreement controls.

B. If there is a conflict between the Agreement and the Response, then the Agreement controls.

C. If there is a conflict between the Response and an Exhibit, then the Exhibit controls.

D. If there is a conflict between the Response and the RFP, then the Response controls.

E. If there is a conflict between the Agreement and the RFP, then the Agreement controls.

F. Included in the Response are terms and conditions of ABC's standard agreements. Such terms and conditions are, for the purposes of this Agreement, void and shall not govern the relationship between City and ABC.

11.13 **MODIFICATION OF AGREEMENT.** ABC and City expressly agree that this Agreement cannot be modified except in writing executed by both ABC and City.

11.14 **LEGAL CONSTRUCTION.** If one or more of the provisions of this Agreement are for any reason held to be invalid, illegal, or unenforceable in any respect, such invalidity, illegality, or unenforceability shall not affect any other provision of this Agreement; and this Agreement shall be construed as if such invalid, illegal, or unenforceable provisions had never been contained in this Agreement.

11.15 **WAIVER.** Any waiver by ABC or City of any provision of this Agreement shall not imply a subsequent waiver of that or any other provision. And, further, any waiver must be signed in writing by the party against whom such waiver is to be construed.

11.16 **BINDING EFFECT.** This Agreement shall inure to the benefit of and bind the parties hereto, their successors, and permitted assigns.

11.17 **AUTHORITY.** ABC and City hereby warrant and represent that their respective signatures set forth below have been, and are on the Effective Date, duly authorized by all necessary and appropriate statutory, corporate, and/or governmental action to execute this Agreement.

11.18 **CAPTIONS.** All captions contained in this Agreement are for convenience or reference only and are not intended to define or limit the scope of any provision of this Agreement.

11.19 **MISSPELLINGS.** Misspellings of one or more words in this Agreement shall not vitiate this Agreement. Such misspelled words shall be read so as to have the meaning apparently intended by the parties.

11.20 **NO JOINT VENTURE.** ABC and City agree that ABC will assume the role of an independent contractor pursuant to this Agreement. In no event shall this Agreement be construed as creating any partnership, joint venture, agency, or other relationship between ABC and City.

Exhibit 5.2 *(continued)*

11.21 **COMPLIANCE WITH LAWS.** ABC expressly agrees that during the term of this Agreement, it shall observe and comply with all relevant laws, including, without limitation, federal, state, and local laws, ordinances, orders, decrees, and regulations.

11.22 **INFRINGEMENT.** If any item used by ABC to provide the Services described in the Section titled **"DESCRIPTION OF VENDOR SERVICES"** becomes, or in ABC's reasonable opinion is likely to become, the subject of an infringement or misappropriation claim or proceeding, ABC shall promptly take one of the following actions at no additional charge to the City and in the listed order of priority:

A. Secure the right to continue using the item;

B. Replace or modify the item to make it non-infringing, provided that any such replacement or modification will not degrade the performance or quality of the affected component of the Vendor Services; or

C. Remove the item from the Vendor Services and equitably adjust the charges to reflect such removal.

IN WITNESS WHEREOF, ABC and City, through their duly authorized representatives, make this Agreement effective upon the Effective Date.

Active Business Corporation

By:________________________

President

Approved:

____

, Senior Counsel

The City of Example, Any State

By:________________________

City Manager

Approved as to Content:

____

, IT Team Leader

Approved as to Form:

____

, City Attorney

Attest:

____

, City Secretary

Exhibit 5.2 *(continued)*

Exhibit A

Definitions

The following definitions shall apply to the terms used in this Agreement.

1. Agreement

   The term "Agreement" means this Agreement and any Addenda, Exhibits, or other written amendments, provided the said written amendments have been properly executed by the parties to this Agreement.

2. Agreement Term

   The term "Agreement Term" shall mean that period beginning with the Effective Date and continuing for five (5) years.

3. Client

   The term "Client" shall mean the City of Example, Any State.

4. Client Designated Executive

   The term "Client Designated Executive" shall mean the Assistant City Manager.

5. Client Liaison

   The term "Client Liaison" shall mean Jane Smith, IT Team Leader.

6. Defect

   The term "Defect" shall mean any Defective Performance that occurs during a day, excluding events totally beyond Vendor's control that do not arise, in whole or in part, from the negligence or intentional misconduct of Vendor or any of its agents or employees.

7. Defective Performance

   The term "Defective Performance" shall mean Vendor's failure to perform in accordance with the Performance Indicators.

8. Effective Date

   The term "Effective Date" shall mean the date that this Agreement becomes effective.

9. Excluded Services

   The term "Excluded Services" shall mean those services listed as such in Exhibit B [*included in this publication*].

10. Exhibits

    The term "Exhibits" shall mean the following exhibits to this Agreement, and any other Exhibits that the parties agree by signed amendment should become a part of this Agreement:

    Exhibit A, Definitions [*included in this publication*]

    Exhibit B, Vendor Services [*included in this publication*]

    Exhibit C, Vendor Fees [*not included in this publication*]

    Exhibit D, Schedule of Events [*not included in this publication*]

    Exhibit E, Client's IT Employees [*not included in this publication*]

Exhibit 5.2 *(continued)*

Exhibit F, Client's Existing Hardware and Software Agreements [*not included in this publication*]

Exhibit G, Performance Indicators [*included in this publication*]

11. Expiration Date

The term "Expiration Date" shall mean the date on which this Agreement expires.

12. Force Majeure Event

The term "Force Majeure Event" shall have the meaning set forth in Section 11.8 of this Agreement.

13. Guaranteed Period

The term "Guaranteed Period" shall mean the first year following the Effective Date, during which Vendor may terminate an IT Employee only for cause.

14. IT

The term "IT" shall mean Client's internal Information and Technology Services Department, consisting of Data Processing and Communications Divisions.

15. IT Employees

The term "IT Employees" shall mean Client's Information and Technology Services employees, listed in Exhibit E [*not included in this publication*].

16. Mediation Notice

The term "Mediation Notice" shall have the meaning provided in Section 6.2 of this Agreement.

17. Performance Indicators

The term "Performance Indicators" means the measures specified in Exhibit G [*included in this publication*] of this Agreement.

18. Production Defect

The term "Production Defect" shall mean a Defect arising from ABC's failure to meet a Performance Indicator set forth in Exhibit G [*included in this publication*] under the listing "Services" that requires on-time production of any of the following items:

a. Payroll

b. Utility bills

c. Tax notices

d. Periodic reports

19. Quarter

The term "Quarter" shall mean the period of time so specified in Exhibit G [*included in this publication*].

20. Schedule of Events

The term "Schedule of Events" shall mean the agreement of the parties to perform their respective obligations in accordance with Exhibit D [*not included in this publication*] of this Agreement.

Exhibit 5.2 *(continued)*

21. Supplemental Services

    The term "Supplemental Services" shall mean all services requested by Client that are not Vendor Services.

22. Standard Vendor Services

    The term "Standard Vendor Services" shall mean those services so specified in Exhibit B [*included in this publication*] of this Agreement.

23. System Availability Defect

    The term "System Availability Defect" shall mean a Defect arising from Vendor's failure to meet a Performance Indicator set forth in Exhibit G [*included in this publication*] under the listing "Systems Availability: Workstations."

24. Task Estimate

    The term "Task Estimate" shall mean a written estimate provided by Vendor to Client of the total cost of performing Additional Services, as set forth in Section 2.2 of this Agreement.

25. Termination Date

    The term "Termination Date" shall mean the date on which termination of this Agreement is effective.

26. Turnback Deliverables

    The term "Turnback Deliverables" shall have the meaning set forth in section 8.9D of this Agreement.

27. Turnback Period

    The term "Turnback Period" shall have the meaning provided in Section 8.9 of this Agreement.

28. Turnback Services

    The term "Turnback Services" shall have the meaning provided in Section 8.9C of this Agreement.

29. Vendor

    The term "Vendor" shall mean ABC.

30. Vendor Designated Executive

    The term "Vendor Designated Executive" shall mean the ABC Vice President.

31. Vendor Fees

    The term "Vendor Fees" shall mean the fees Client shall pay Vendor pursuant to this Agreement, as described in Exhibit C [*not included in this publication*].

32. Vendor Liaison

    The term "Vendor Liaison" shall mean John Doe, Account Manager.

33. Vendor Licensed Software

    The term "Vendor Licensed Software" shall mean Vendor's third-party software and documentation used to provide the Vendor Services.

Exhibit 5.2 *(continued)*

34. Vendor Services

    The term "Vendor Services" shall mean the services Vendor will perform pursuant to this Agreement, as described in Article Two and Exhibit B [*included in this publication*] of this Agreement.

35. Vendor Software

    The term "Vendor Software" shall mean Vendor's own software and documentation used to provide the Vendor Services.

Exhibit 5.2 *(continued)*

Exhibit B

Vendor Services

ABC agrees to provide the following Information Technology (IT) Services to the City of Example by providing management and operational support for City of Example equipment as identified in this exhibit. ABC also agrees to use reasonable demonstrable efforts and its best business judgment in managing and operating the City of Example's IT. The City of Example has made its best effort to provide ABC with a comprehensive list of all current systems, hardware, and outstanding requests for service. ABC agrees to support any items inadvertently left off said list but verified as having existed at the time of the Agreement. ABC will within one hundred and eighty (180) days of contract startup complete an inventory of City of Example IT hardware and equipment. The updated inventory will be reviewed by the City of Example Contract Administrator and updated in this Exhibit once approved. ABC will upon the anniversary of the updated IT Inventory provide annual updates to be included in this Exhibit.

I. Standard Vendor Services

1.0 Management

1.1. General

A. Represent IT for all internal and external management and city council worksessions and meetings as necessary

B. Establish and serve as a cofacilitator and member of an IT Steering Committee and be a member and serve as chairperson for an IT Tactical Planning Committee and IT User Group(s)

C. Cooperate with all required City external audits

D. Manage use of PC standards as developed by ABC and the City of Example

E. Provide the management and staffing necessary to maintain the City of Example's Web page

1.2. Planning

A. Establish, gain approval for, and manage the IT budgets according to City of Example's standards, for all areas identified in this Exhibit, including hardware and software vendor contracts and capital projects

B. Develop and implement a Strategic Long-Range Plan with direct support and participation by City Management and the IT Steering Committee

C. Plan for upgrades of hardware, software, and application programs

D. Prepare and present new requests for proposal and cost/benefit analysis to the IT Steering Committee

1.3. On-site Consulting

A. Develop, implement, and maintain hardware and software standards, procurement policies, and inventory to be applied Citywide and in accordance with state law

B. Provide consulting services as requested by users and departments and as dispatched by the help desk

Exhibit 5.2 *(continued)*

1.4. Off-site Consulting

A. Make available to the City of Example professional consulting services of up to eight (8) hours per month (noncumulative) performed by ABC Regional or Corporate staff. The City of Example shall direct the level and type of consulting services required

1.5. Procurement

A. Order, requisition, review, validate, and pay invoices for IT services and/or supplies

B. Manage vendor costs

C. Minimize cost incurred by outside vendors to the extent possible and practical within existing agreements and as provided by state law

D. Provide vendor interface and contract management for all hardware vendors; general and application software vendors; and suppliers of data processing supplies, computer forms, and computer peripheral devices

E. Recommend alternative vendors, if available, for similar or enhanced services at reduced cost

F. Initiate and implement requests for proposal (RFPs), bids, and requests for qualifications (RFQs) as needed to comply with state laws and local procedures

2.0 Operations

2.1. Production

A. Produce payroll, utility billing, and tax billing

B. Produce tapes to be supplied to various outside companies

C. Prepare tapes of reports for microfiche process

D. Schedule and log of input, output, pickup, and delivery of data

E. Balance reports and batch activities

F. Produce and distribute reports

G. System balancing of data

H. Check data integrity

I. Management of user interface and scheduling of input and output processes and terminal availability

2.2. General

A. Maintain computer room in a clean and secure manner

B. Maintain efficiency of computer operations

C. Standardize operations documentation

D. Maintain operating logs for IT operations

E. Retain files and manage storage

F. Provide for system backup and off-site storage for critical files

Exhibit 5.2 *(continued)*

G. Provide for contingency plans and backup

H. Reorganize database files as may be appropriate

I. Maintain PC, mini, and mainframe hardware, software, and telecommunications inventory list

J. Manage and administer City of Example's Disaster Recovery Plan and testing in terms of data and telecommunications

K. Adhere to records management as per State regulations and City policy

L. Administer security for all applications

M. Provide twenty-four (24) hour on-call emergency support

N. Provide all wiring and maintenance for panic alarm circuits, telco circuits, computer network, and data lines

O. Order and distribute telephone company directories

P. Support and manage the network

Q. Maintain PCs and peripherals to City standards

R. Provide on-site office during City's normal business hours (Monday through Friday, 8:00 A.M. to 5:00 P.M., excluding City holidays)

S. Provide a test environment for updates to all business application packages

T. Administer local phone service, long distance service, cellular phone service, and pager service, which are funded by the city

2.3. Hardware and Equipment

A. Provide scheduling, input, output, systems backup, and vendor preventative maintenance

B. Provide troubleshooting service

C. Provide maintenance and support for hardware and equipment for IT

D. Coordinate and provide all moves, adds, and changes for data processing and telecommunications

2.4. Software

A. Implement, coordinate, and document all operating system, application, and utility software vendor upgrades and communicate and assist when such upgrades affect users

B. Provide a backout plan and end-user training for software upgrades

C. Provide necessary new software usage specifications and related information for proposal cost/benefit analysis

D. Provide troubleshooting service

E. Maintain and support software in accordance with licensing agreements

F. Maintain a software library

G. Program ad hoc reports in accordance with software licensing agreements

Exhibit 5.2 *(continued)*

2.5. Help Desk

A. Provide the management and staffing necessary to provide full operational control and functional responsibility for the help desk

B. Provide a single focal point for all help requests and requests for service related to IT operations in this Exhibit and track all help requests and requests for service

C. Provide feedback and status reporting to City of Example management

D. Receive, log, handle, and, route help requests and requests for service appropriately

E. Resolve user requests and problems within the IT Center

F. Provide loaner equipment (for example, laptops and data projectors) on a reservation basis to departments

2.6. Training

A. Provide equipment installation for an on-site training center

B. Support and operate equipment and hardware for IT-related training functions

C. Coordinate and provide on-site end-user training for appropriate applications and manage end-user training in use of personal computer tools and telecommunications services

3.0 Management Reporting and Meetings

3.1. Management Reports

A. Prepare monthly summary status reports regarding IT activities as well as unresolved issues

B. Report monthly system usage levels

C. Report monthly service levels

D. Provide quarterly customer service surveys for one year from the effective date of this Agreement following with annual customer service surveys for each year beyond the first year

E. Provide status reports for ongoing and proposed projects

F. Respond to information requests

3.2. Management Meetings

A. City of Example Contract Administrator and ABC Account Manager, weekly

B. ABC Account Manager and Management Team, weekly and as scheduled

C. Departmental meetings, monthly

D. Review with Executive Management Team and senior ABC Representative, annually and as required

E. Year-in-Review Presentation, as requested by City Management

F. IT Steering Committee, as needed

G. Representation in user group meetings, as requested and as scheduled

Exhibit 5.2 *(continued)*

II. Excluded Services

1.0 The following items are specifically excluded from the scope of this Agreement, and ABC shall have no responsibility for the following matters, except as Additional Services:

A. Public Safety software provided by XYZ and the related onsite support and operations

B. 911 telephone systems software and xxx 911 hardware, including related onsite peripherals

C. Library hardware and software maintenance within scope of contract with __ Inc., and related operations

D. Library "dial-info" services

E. Traffic control microwave system and field controllers, signals, and video equipment

F. Radio operations and equipment

G. Video security systems

H. Fire and security alarm panels

I. Copy machines

J. Fax machines

K. Micromedia readers and printers

L. Water meter reading system

III. Projects

A. Help Desk Implementation

B. Training Center Set Up, with 10 PCs

C. Strategic Technology Plan and Annual Updates

D. Year 20XX Assessment

E. Telecommunications Assessment

F. Disaster Recovery Plan and Annual Updates

1.0 Within ninety (90) days of this Agreement, ABC and City will mutually agree to terms, conditions, and specifications in connection with the following projects. ABC and City agree that Exhibit C [*not included in this publication*] may be modified to better reflect project specifications and actual costs.

A. Design and install a City-wide network

B. Provide functional access to the network by three hundred (300) workstations

C. Upgrade City's mainframe

D. Provide continuous power for the mainframe

E. Provide a call accounting system

Exhibit 5.2 *(continued)*

IV. Outstanding Service Requests

[*Include a listing of outstanding service requests and their current status for IT services within the City.*]

V. Information and Technology Hardware and Equipment

[*Include a detailed listing of IT hardware and equipment to be maintained under the contract.*]

Exhibit 5.2 *(continued)*

Exhibit G

Performance Indicators

Performance indicators have been established to accurately reflect the level of service to be provided to the City of Example. Performance indicators will also be used as management tools for providing planning and resource distribution.

Ninety (90) days from the effective date of this Agreement, ABC will commence the tracking and monitoring processes.

The following are items that the City of Example and ABC have mutually agreed will affect some of the performance indicators.

- Equipment life and reliability
  —The product life and vendor support of any given hardware, firmware, and infrastructure product has a direct impact upon the ability to achieve maximum performance and reliability.
- Policy and license violations
  —Any unauthorized hardware or software for which there is no legal license voids ABC's responsibility and indicator for said system.
- Vendor impact
  —Errors in patches or upgrades supplied by third-party vendors that affect service delivery are not considered as having affected said performance indicator.
- Impacting standard
  —Those nonroutine customer processes including, but not limited to, customer-provided data, system run requests, and reports that have an adverse impact are excluded from the performance indicator (for example, double utility billings, urgent notices, payroll, W2 processing, finance year-end closing, and excessive number of reports delay system availability, end user report delivery, and application system performance).
  —System installations, migrations, or upgrades performed without prior consent of ABC management staff is excluded from being part of the performance indicator.
- Technology replacement fund
  —Several technology components are outdated, nonexistent, unsupported, unstandardized, or in a state of disrepair. Such systems include hardware, software, firmware, diagnostic tools, backups, fault tolerance, infrastructure wiring, routers, operating systems, and monitoring tools.

It is anticipated the City of Example will maintain appropriate funding to accommodate replacing these vital components to achieve satisfactory levels of service.

Exhibit 5.2 *(continued)*

PERFORMANCE INDICATORS

This section contains the narrative of the performance indicators. Each service level is stated with a detailed narrative of service deliverables, premises, and responsibilities.

The following are summarized services documented in this chapter.

Services provided include—

I. Systems Availability
II. Scheduled Services
III. Requests for Service

I. Systems Availability: Workstations

Service response	Availability: workstations
Performance indicator	99%
Description	Availability is the percentage of hours that workstations have access to the mainframe, mainframe, servers, processors, operating and telecommunications systems are available, less scheduled outages and excluding systems failures outside ABC's control.
Evaluation period	Monthly
Performance indicator premises	Indicator applies to all IT systems.
City responsibilities	City is to fund ABC recommended mainframe hardware replacements.
ABC responsibilities	ABC performs evaluation of all systems and provides appropriate recommendations. ABC coordinates and schedules periodic maintenance.
Reporting	Quarterly report depicting performance indicator

I. Systems Availability: Response Time

Service response	Systems response time of 2 seconds Maximum response time of 4 seconds
Performance indicator	95% on systems response time 100% on maximum response time
Description	All systems should respond on inquiry to users within 2 seconds 95% of the time with a maximum response time of 4 seconds 100% of the time, less scheduled outages and excluding systems failures outside ABC's control.

Exhibit 5.2 *(continued)*

I. Systems Availability: Response Time *(continued)*

Evaluation period	Quarterly
Performance indicator premises	Indicator applies to all IT systems, excluding dial up.
City responsibilities	Fund ABC recommended mainframe hardware replacements.
ABC responsibilities	ABC performs evaluation of all systems and provides appropriate recommendations. ABC coordinates and schedules periodic maintenance.
Evaluation procedure	City and ABC shall jointly measure performance at a predetermined date once per month to obtain a quarterly performance average. Three (3) different locations shall be selected with actual measurement being performed by ABC Account Manager and City Contract Administrator or their designee. A stopwatch will be used to record and document the measure. The measure will be from the time the station enters inquiry until the response is received.
Reporting	Quarterly report depicting performance indicator

II. Scheduled Services

Service response	Production schedule
Performance indicator	100% on time, as scheduled
Description	The schedule describes on-time production of payroll, utility billing, tax billing, W2s, and 1099s, excluding failures outside ABC's control.
Evaluation period	Quarterly
Performance indicator premises	This indicator applies to the production of items that are a necessary function to operate a City on a daily basis. ABC and City staff will mutually establish processing and production schedules.
City responsibilities	City will coordinate with ABC on a mutually established production schedule.

(continued)

Exhibit 5.2 *(continued)*

II. Scheduled Services *(continued)*

ABC responsibilities	ABC is to develop processes to monitor and report performance indicator.
Reporting	Quarterly report depicting actual results versus performance indicator

Service response	Production of system management and periodic reports
Performance indicator	100% on time, as scheduled
Description	This schedule of services is a means to produce systems management and usage reports with recommendations for hardware, equipment, and software improvements as necessary. This includes trend and failure analysis.
Evaluation period	Monthly
Performance indicator premises	Indicator applies to all activities associated within Information Technology (IT) and other departments as necessary.
City responsibilities	City is to review and consider recommendations.
ABC responsibilities	ABC is to evaluate systems and make recommendations. ABC is to coordinate and schedule periodic maintenance.
Reporting	Monthly report depicting usage levels and recommendations

Service response	Annual customer service survey
Performance indicator	100%
Description	ABC must provide friendly, professional service to all users of their services. ABC is to perform an annual customer service survey to evaluate customer satisfaction.
Reporting frequency	Annually
Performance indicator premises	Indicator evaluates customer service through vendor responsiveness, professionalism, and effectiveness.
City responsibilities	City is to cooperate with periodic questionnaires and provide direct feedback.

Exhibit 5.2 *(continued)*

II. Scheduled Services *(continued)*

ABC responsibilities	ABC establishes a culture that promotes the indicators.
Reporting	Quarterly reports depicting results of survey the first year of contract; annual reports thereafter

Service response	User group meetings
Performance indicator	Quarterly, or as scheduled
Description	Meetings are intended to develop improvements in customer service through user group feedback.
Reporting frequency	Quarterly
Performance indicator premises	Provide a mechanism for listening, participation, and teamwork.
City responsibilities	City staff should agree to participate and provide feedback in user group meetings. City will designate staff who will be involved in user group meetings.
ABC responsibilities	ABC is to lead and participate in user group meetings.
Reporting	Quarterly report outlining feedback and recommendations from user groups

Service response	Quarterly newsletter to all users
Performance indicator	100% on time
Description	A quarterly newsletter will be developed and distributed to all IT users to provide information on IT activities.
Reporting frequency	Quarterly
Performance indicator premises	This is designed to keep the City informed of IT news, events, and future changes.
City responsibilities	City is to review and provide feedback to ABC.
ABC responsibilities	ABC is to prepare and distribute quarterly newsletter.
Reporting	Quarterly distribution of newsletter

Service response	Desktop, network, and telecommunications training
Performance indicator	65 hours per month

(continued)

Exhibit 5.2 *(continued)*

II. Scheduled Services *(continued)*

Description	Training is to be provided to City staff in desktop, network, and telecommunications training.
Evaluation period	Quarterly, averaged annually
Performance indicator premises	An on-site location will be provided for City staff to become more effective and efficient in their positions.
City responsibilities	City is to fund the equipment and hardware for an on-site training center.
ABC responsibilities	ABC is to develop, schedule, and conduct on-site training.
Reporting	Quarterly reporting of performance indicator

III. Requests for Service

Help desk services are provided for the IT systems. Help desk requests and responses may be provided in multiple forms (for example, phone, inter-office mail, e-mail, and fax).

Service response	Respond to customer requests within 2 business hours not to exceed a maximum of 4 business hours
Performance indicator	90% within 2 hours 100% within 4 hours
Description	Response is to be provided to supported City staff within 2 hours of a logged call to the help desk, where a follow-up assessment time frame will be given.
Evaluation period	Quarterly
Performance indicator premises	Indicator applies to all incoming help desk requests. Support time applies to Monday through Friday, 8:00 A.M. to 5:00 P.M., excluding holidays.
City responsibilities	City is to fund ABC recommended help desk system. City is to contact help desk directly for assistance. City is to have staff reporting incident be present when ABC staff responds.

Exhibit 5.2 *(continued)*

III. Requests for Service *(continued)*

ABC responsibilities	ABC is to establish help desk user procedures. ABC is to log reported outage in help desk system and notify support staff. ABC is to respond to City staff for assessment time frame. ABC is to ensure that all users of any system are notified when systems are scheduled for down time or are down due to unscheduled problems.
Reporting	Quarterly report identifying status and recommended procedures and processes

Service response	Help requests and requests for services logged
Performance indicator	100%
Description	This service will log all help requests and requests for services.
Evaluation period	Quarterly
Performance indicator premises	Indicator applies to all incoming help desk requests. Support time applies to Monday through Friday, 8:00 A.M. to 5:00 P.M., excluding City holidays.
City responsibilities	City is to fund ABC recommended help desk system. City is to contact help desk directly for assistance.
ABC responsibilities	ABC is to establish help desk logging procedures. ABC is to log all reported requests and contacts in the help desk system.
Reporting	Quarterly report depicting actual results versus performance indicator

Service response	Resolve all outstanding help requests and requests for service
Performance indicator	100%
Description	This provides resolution of all help requests and requests for service excluding those reprioritized by City staff.
Evaluation period	Quarterly

(continued)

Exhibit 5.2 *(continued)*

III. Requests for Service *(continued)*

Performance indicator premises	Indicator applies to all incoming help desk requests. Support time applies to Monday through Friday, 8:00 A.M. to 5:00 P.M., excluding holidays.
City responsibilities	City is to fund ABC recommended help desk system.
ABC responsibilities	ABC is to establish help desk user and log in procedures. ABC is to log all reported requests and contacts in the help desk system. ABC is to monitor and track all reported requests and contacts.
Reporting	Quarterly report depicting actual results versus performance indicator.

Chapter 6:

Case Studies

The case studies presented in this chapter provide a look at the real-life experiences of fellow CPAs and serve to illustrate other areas of discussion within the larger text. The scenarios depicted involve the outsourcing of common functional areas within a government or not-for-profit organization: mailroom operations (see Case Study A), fulfillment and distribution functions (see Case Study B), risk management functions (see Case Study C), and solid waste functions (see Case Study D). How each entity deals with the question of outsourcing follows a decision-making process rooted in a necessary self-examination of operations and a functional analysis of the area under review.

The case studies illustrate how using competition can result in measurable improvements in operations, including improved service delivery, increased employee efficiency and productivity, and substantial cost savings.

To illustrate the concepts discussed throughout this publication, the first three case studies present various competition situations in a summary format; the fourth case study, "Example Government Solid Waste Function," contains a detailed assessment of the competition opportunity and illustrates the decision-making process behind the discussions covered in chapters 1 to 5.

Case Study A

Arizona Department of Economic Security
Privatization of Mailroom Operations

By Dr. Linda J. Blessing, CPA, CFE
Executive Director, Arizona Board of Regents

EXECUTIVE SUMMARY

This case study illustrates some of the concepts concerning identifying good opportunities for introducing competition in a governmental operation (see chapter 2). Specifically, it illustrates how such factors as a strong marketplace for provision of services, a strong potential for improved quality of service, and minimal adverse employee impact helped create an environment for the successful privatization of a large mail delivery service in a government operation.

Mailroom operations were privatized by Arizona's largest state agency, the Arizona Department of Economic Security (DES). In-house mailroom services had experienced problems, including high turnover, slow response to agency needs, lack of customer orientation, antiquated and insufficient equipment, and overall poor service. The agency formed a cross-functional process improvement team to study operations. Through its process, the team determined this service was a candidate for privatization. Outcomes included improvement in cycle time, reduction in the per piece cost of mail, compliance with federal regulations, and successful redeployment of employees.

BACKGROUND

The Arizona Department of Economic Security is Arizona's largest state agency, with more than 9,000 employees and $2.5 billion in annual state and federal resources. The agency provides approximately fifty human service programs, including public assistance, unemployment insurance, job services, child support enforcement, and child protective services. Because of the nature of the work conducted, the agency had placed demands on the mailroom operations, which was responsible for mailing checks and government benefits to constituents as well as sending documents internally and externally. Before the decision to privatize this service, the mailroom operations had been under scrutiny for a multitude of problems, including being slow to respond to the changing needs of the agency, not being customer oriented, using antiquated and insufficient equipment, and generally providing poor service. Previous studies had been conducted and "quick fixes" had been made, but the problems continued. While the work of the mailroom was critical to the overall operations, the agency recognized that the functions were not part of the core competency of the organization. Management identified this operation as a prime area for improvement.

SUMMARY OF STEPS TAKEN

Once the issue was identified, management convened a cross-functional team consisting of stakeholders from key areas as well as staff who had expertise necessary to recommend improvements to the operations. The team ensured that all other stakeholders within the agency were kept apprised of progress. Staff were also invited to attend team meetings when subjects directly involved their areas of specialty. The team studied the "as is" condition of the operation and found that salaries were inadequate, staff turnover was 67 percent, excessive overtime was incurred, morale was low, records were insufficient and kept haphazardly, and only four million of ten million pieces of mail were bar coded. Services were inadequate to meet the organization's needs. The operation had to outsource some mass mailing to vendors because of the demanding workload. Operations were becoming fragmented to the point where some areas within the organization were setting up their own mail operations. In addition, new postal service regulations would necessitate purchase of additional equipment to take advantage of reduced rates.

The team was unable to design solutions to high turnover, unable to find the funds needed to purchase new equipment, and unable to add additional space to meet the increasing demands of the agency. The team identified companies within the private sector that performed this function. This option was explored, and the team found outsourcing could provide the following: a stable workforce; more efficient use of current equipment; complete, automated records; better utilization of available space onsite; and savings on postage costs.

Team members developed an analysis of the current and projected costs to maintain mail operations in house. Mail management firms were asked to provide estimates of their costs to take over and maintain the operation. Estimates indicated that privatization was possible without increased costs and that potential cost avoidance was anticipated.

A request for proposals (RFP) was drafted, and the intent to privatize was advertised. Major issues identified by customers were included in the RFP. Issues included confidentiality and data security. Also, vendors were asked to hire as many existing mailroom employees as desired. The remainder were redeployed within the agency.

Lessons Learned

Top management commitment to keeping employees informed and to ensuring that employees were either hired by the new service provider or reassigned elsewhere in the agency helped make this effort to introduce competition successful. Agency top management routinely reviewed the names and background of employees affected by the mailroom privatization to ensure that opportunities for reassignment were identified. In addition, mailroom employees were continuously kept apprised of the progress of the privatization effort. Since the mailroom operation was one of the agency's early privatization efforts, positive employee perception helped the agency gain support for subsequent efforts.

How Performance Improved

An outside private sector company was awarded the contract. A number of major objectives have been realized. New procedures continued to be implemented to increase efficiency and cost-effectiveness. Accomplishments included a 22 percent reduction in the per-piece cost for in-house processed outgoing mail, improvement in cycle time by up to three days on large mailings, an estimated 15 percent increase in the quantity of outgoing mail without a corresponding increase in agency cost, compliance with new U.S. Postal Service regulations, and no adverse impact for employees.

In addition to improved performance, the agency realized other benefits. The contractor assumed responsibility for all mail-related production equipment, and the agency was no longer responsible for bearing the costs of maintenance agreements on equipment. After one year, the contractor had the option of purchasing the equipment, and any equipment not purchased was sent to the state surplus property operation. Purchase of new equipment necessary to meet revised U.S. Postal Service requirements was the contractor's responsibility. Also, five vehicles that had been used by the agency (three owned and two leased) were not needed by the contractor and were available for use by other state programs.

ROLES FOR CPAS

The privatization of a central mailroom operation affords many opportunities for a CPA to make a contribution, whether the CPA is employed within the organization or is engaged as a consultant. For example, a CPA could be helpful in assessing whether the mailroom operation is a viable target function for privatization, conducting a cost analysis of the operation, preparing an RFP, and preparing personnel plans to minimize the adverse impact on employees.

FOLLOW-UP INFORMATION

The actual procurement of goods and services can be either centralized within a unit of the agency itself, or decentralized with various responsibilities spread out among various state purchasing units and employees. The DES, the agency involved in this case study, has a centralized purchasing function and the procurement of goods and services falls under the oversight of the Office of Procurement and Operations Support (OPOS).

"Within OPOS there are two procurement sections—the Contracts Management Section and the Purchasing Office. The DES Contracts Management Section is a decentralized unit with program offices and staff located throughout the state. The program offices deal specifically with contract providers for client related services."[1]

If you have questions or for further information regarding the privatization of the Arizona Department of Economic Security's mailroom operations, please contact the Contracts Management Section at (602) 364-0197.

The DES home page can be found at www.de.state.az.us.

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[1] Office of Procurement and Operations Support, www.de.state.az.us/links/business/opos.html.

Case Study B

National Geographic Society Outsourcing of Fulfillment Function

By Theresa Bachmann, CPA, Vienna, VA

BACKGROUND

Founded in 1888, the world-renowned National Geographic Society had enjoyed a unique position within the publishing industry for more than 100 years. Unparalleled in quality and excellence, it has had relatively few, if any, credible competitors. By the early 1990s, however, the Society's market position was clearly changing. The publishing and entertainment industries were rapidly evolving. New competitors, such as the Discovery Channel, were changing the rules of the game and although the full effect of the burgeoning Internet was still unknown, it was clear that major changes would be necessary to compete in these industries.

By the mid-1990s, the Society's executive management could see the writing on the wall. Although the organization maintained record revenues, membership levels (the Society's equivalent of magazine subscriptions) had begun to decline. Even though the 9 million recipients of the Society's most well-known magazine, *National Geographic*™, were loyal (approximately 85 percent renewed annually) and represented demographics attractive to many advertisers, membership had dropped precipitously from its high of 11 million in 1989. In addition, margins on various National Geographic product lines (for example, books, videotapes, educational films, and maps) were tightening.

The reality of these operating results prompted management to make difficult strategic decisions. The Society decided that to fully pursue its mission to "increase and diffuse geographic knowledge" it needed to reinvent itself as a modern multimedia business. However, this type of transformation would require capital. To improve operating performance, management looked to introduce competition into almost every aspect of its operations. The strategic decisions of the mid 1990s continue to direct the Society's operations today. Many of the significant strategic investments made since that time (for example, international expansion and the National Geographic Channel) have been made possible by economies created through the introduction of competition. The following case study describes some of the details surrounding the Society's decision to introduce competition into one of its largest and most costly functions—the fulfillment of magazines and products.

In the publishing industry, fulfillment roughly equates to customer service, and more specifically includes order and payment processing, data entry, customer request servicing, and customer communications (for example, invoicing and renewal notices). These functions, as well as the distribution and warehousing of many products, were performed at the Society's 500-acre Member Service Center in Gaithersburg, Maryland. Annually, Member Services processed over 17 million pieces of mail, serviced approximately 1 million telephone calls, and made deposits of over $400 million into the Society's accounts.

Despite several years of efforts to decrease expenses, the Society's costs to fulfill each product and magazine order surpassed those of any organization with which the Society compared itself. Fundamentally, the workforce employed at the facility was costly and the information systems were limited. The average employee had worked for the Society for more than twelve years and the Washington, D.C., area demanded higher wages and benefits. Current information systems could not facilitate the international expansion envisioned by management and did not have the capacity to capture and manipulate the information necessary to market the Society's membership effectively. Therefore, a significant investment in technology would be necessary if the Society were to execute many of its strategic initiatives.

The Society gave particular consideration to three options—partnering, relocation, and outsourcing. In the first option, the Society considered working with a partner to invest and create a new fulfillment company—one that would serve not only the Society, but also other magazines and publishers. By contributing its fulfillment acumen and gaining economies of scale by serving others, the Society estimated that the venture would be profitable within five years. However, the initial investment and risks for failure were great, and the payoff, if any, would be long-term. In the second option, the Society considered relocating to a less expensive region of the country, but that too appeared to have too much of a short-term investment with limited long-term benefits. So after analyzing the market for potential vendors and upon the culmination of months of analysis, the board of trustees approved management's recommendation to outsource the Society's fulfillment operations. The Society also accepted an attractive bid for its 500-acre facility in Maryland. These actions set in motion a no-turning-back transition period in which the Society had approximately ten months to transition twenty-three businesses or product lines. Some of these businesses included the following:

- Magazine services
  - —*National Geographic*
  - —*World*
  - —*Traveler*
- Product services
  - —Consumer catalog
  - —Educational catalog
  - —Single shot books
  - —Continuity books
  - —Online store
  - —Maps
  - —Globes
  - —Slipcases
  - —Calendars
- Other services
  - —Geography Bee
  - —Geographic Education Program
  - —Lectures
  - —Development office
  - —Market research

Lessons Learned: Applying the Eight Criteria for Success

The following considers the Society's decision to outsource its fulfillment operations by applying the eight criteria for success (see chapter 2).

Strength of Competitive Market

The market for fulfillment vendors was strong. Several facilities had proven track records capable of handling the volume of the Society's businesses and providing these services more cost-effectively. However, the services provided by the Society's membership service center had become very specialized. The Society's members had always enjoyed the ultimate, one-stop shopping experience. With a single call to the member service center, for example, a member could renew the magazine, place gift orders for magazine shipments to China and Canada, arrange for credit card payment for a previous book purchase, and order a videotaped copy of last year's award-winning National Geographic Special on the tigers of eastern Asia. A single customer service representative could address these requests, and all of this activity could be reflected on a single account statement to the member. Despite a strong market for fulfillment services, no single vendor could deliver all these services. Therefore, Society management accepted from the outset that outsourcing fulfillment meant working with several vendors. Management was concerned that fracturing customer service would have a particularly negative impact on the 20 percent of members who purchase from two or more of the Society's businesses. To address this issue, the Society required its vendors to employ customized telephone relaying services to minimize duplication of a member's requests and coordinate the vendors' services as closely as possible.

Quality of Service

The Society is renowned for its quality of service. Therefore, the issue of quality was paramount to the Society's management and its board of trustees. As noted previously, the coordination of services to ensure a seamless transition was a very important component of the decision to outsource fulfillment. The member service center had employed a very extensive quality assurance program. Some of the metrics the Society used to monitor the quality of services included telephone service measures (for example, percent of calls blocked and percent of calls answered) and correspondence, payment, and returns processing measures (for example, percent processed within *x* days). During analysis of potential vendors, the Society noted several vendors had limited quality-assurance programs or programs with goals lower than those at the Society. Therefore, as part of its performance-monitoring plan, the Society required quality-assurance standards during contract negotiations. These contract terms (including the right to audit these programs) were given some "teeth" by tying them to rebate and other incentive terms, which would motivate vendors to maintain high quality standards. Such contract provisions assured the Society that the quality of the members' buying experiences would remain strong and give the Society key statistics to monitor continuing vendor performance.

Control and Oversight

The Society wanted to maintain powers of control and oversight to ensure continuing quality of services and ensure the propriety of financial results. To monitor financial results and quality measures, the Society maintained a staff from the member services center to serve as vendor liaisons and manage any operational issues arising during the transition. This team reviewed daily vendor reports of sales, shipments, and customer service statistics to ensure operational problems were identified and addressed in a timely manner. In addition, the Society's internal audit department was very active in reviewing the accuracy of files transferred to vendors and reviewing the internal controls and operational policies and procedures in place at each major vendor.

Risk and Exposure

The Society considered the following risks to be most pertinent:

- Premature attrition of member service center staff
- Inability to implement transition on schedule
- Inability to properly convert member data
- Business disruption
- Nonperformance of vendors

Collectively, the Society managed these risks by developing comprehensive transition plans for all member service center functions and establishing a fulfillment project team. The plans included schedules of major milestones and detailed budgets for all aspects of the outsourcing. Society management credits the success and relative ease of the transition period to the strength and openness of communication within the project team and throughout the Society. Some of the other specific actions the Society took to address these risks were—

- Awarding "stay bonuses" for staff identified as critical to the transition.
- Bundling businesses to limit the number of vendors.
- Engaging information risk management professionals and the Society's internal audit division to ensure the propriety of member data transfers.
- Purchasing business disruption insurance.

As a result, the Society experienced limited attrition, transitioned business as scheduled, and did not experience unusual business disruptions.

Legal Barriers

The most significant legal issues related to personnel issues. Therefore, legal counsel worked very closely with the transition and human resources personnel to ensure the employment severance transition plan complied with applicable employment laws and regulations.

Political Resistance

The Society's operations had remained largely unchanged for decades, so the proposal to outsource fulfillment was met with initial resistance throughout the Society. As previously discussed, the business environment had significantly changed in the early 1990s and although many in executive management recognized the need for change, they found it difficult to effect change themselves. Therefore, the Society hired a new president from outside the organization to serve as change agent. The decision to consider outsourcing fulfillment was largely due to the president's resolve. Although personally convinced the Society should outsource fulfillment, the president engaged management in discussion of various options for many months. In this way, management reached its own conclusions. As analyses continued, the business case for outsourcing became clear and convincing. The exercise to engage management and staff ensured buy-in at all levels of the organization. Likewise, the board of trustees was much more comfortable with the decision, given executive management's overwhelming support. Although the organization would experience some difficulties, there was support at all levels to see the transition through to a successful completion.

Impact on Employees

The outsourcing of fulfillment led to the termination of approximately 350 jobs, or 30 percent of the Society's workforce. Therefore, the impact on those employees being released as well as on remaining staff was critical. As discussed previously, the Society was particularly concerned with premature attrition of the member services center employees. These employees were long-term, loyal personnel of the Society. Executive management recognized that although the business case to outsource was indisputable, the terminations would certainly cause great turmoil in the lives of its employees. Therefore, the implementation of the Society's personnel plan was as comprehensive as all other aspects of the transition process. Beyond customary severance benefits, employees benefited from self-improvement programs, including personal computer education, résumé writing classes and training on starting businesses and interviewing techniques. The Society maintained a human resource staff on site at the member service center to maintain open dialogue with employees and administer the self-improvement programs. Personnel in human resources also persuaded the state of Maryland to allocate almost $700,000 for the education and benefits of exiting employees. As a result, premature attrition was minimal, and most employees worked diligently and loyally until their last day of employment.

Resources

This final criterion deals with the availability of resources to the vendors to ensure the needed expertise, facilities, equipment, and time to provide quality service. As previously discussed, the fulfillment market is strong and as such, major vendors have achieved economies of scale for significant investments in facilities and equipment. The Society engaged fulfillment consultants to assess the expertise of potential vendors. As such, these assessments assured the Society that the selected vendors had the necessary resources to ensure continuing quality services.

The decision to outsource fulfillment was difficult, particularly due to the adverse effect on the member service center employees and quality concerns resulting from the fracturing of customer service. However, within one year of outsourcing fulfillment, the Society recognized more than $15 million of savings. This ongoing annual savings has made it possible for the Society to make critical strategic investments as it continues to evolve as a modern multimedia business.

Engaging professional assistance was critical to the entire process. Both Society management and staff remained focused on providing quality services, and therefore, others performed much of the transition project administration and special projects.

Roles for CPAs: Decision Makers Needed

Certified public accountants and other fulfillment financial specialists played vital roles. Specifically, some of the analyses and functions performed by external certified public accountants and others included the following:

- Performance of a baseline study to summarize the current state of the Society's fulfillment function
- Performance of a peer review to compare the Society's product services to a select peer group to understand best practices within the industry (The peer report included an analysis of cost structures, process volumes, comparison of organizational structures, staffing and productivity levels, an overview of technologies, and summaries of peer self-assessments.)
- Design of the RFP to define requirements and identify vendor candidates
- Comparison and analysis of proposed vendors
- Service on the fulfillment project team oversight committee
- Transition project administration
- Audit of data transfer from Society to vendor systems
- Analysis of tax issues relating to inventory transfers and other state and local tax matters

In addition, the Society established a financial and controls team. Some team functions included the following:

- Establishment and monitoring of transition budget figures
- Design of inventory shut-down and transfer procedures and reconciliations
- Monitoring of vendor performance levels

Finally, some of the functions of the Society's internal audit division included the following:

- Documentation and testing of vendor internal controls
- Service on the fulfillment project team
- Review and testing of inventory transfer balances

Follow-Up Information

Outsourcing the Society's fulfillment function was an important undertaking. Its importance should not be defined, however, in terms of the magnitude of its cost savings. Its greatest importance will be marked by the future strength and reach of the National Geographic Society as it continues to fulfill its mission of increasing and diffusing geographic knowledge into the twenty-first century.

Case Study C

City of Carrollton
Strategic Outsourcing in Risk Management

By Robert B. Scott, Chief Financial Officer

BACKGROUND

A government of approximately 1,000 employees had a separate risk management function for approximately fifteen years. During this time, claim payments grew modestly. In accordance with good accounting practice, the risk management operation was reported separately as a proprietary (internal service) fund. Full accrual accounting was used, and an annual actuarial study was performed to determine estimated outstanding claims. These estimated future claims were booked as a long-term liability and often resulted in the reporting of a fund deficit, as the actuarial liability often grew at a faster rate than funding increases.

In 1993 the risk manager requested additional duties (for additional salary), stating that a vacant management position could be combined with his to produce a net budgetary savings. A short time later the risk manager recommended bringing all claims adjusting in-house again, demonstrating a net budgetary savings. Both recommendations were adopted by management. Later, when the risk manager left the organization, management maintained the part-time risk manager relationship by reassigning the duties to another employee who had significant other duties.

DISCOVERING A PROBLEM

In 1997, the part-time risk manager left the organization and the entire risk organization was reassigned to a new supervisor. This supervisor was unfamiliar with the risk management area and decided to benchmark annual claims paid to similar governments in the area. This was accomplished through a simple faxed survey, but the results were anything but simple or reassuring. They showed that the government was annually paying four to five times as much for claims as were similar governments.

Armed with the survey results, the supervisor began to investigate further and discovered several facts. First, the high claims were primarily the result of workers' compensation payments. Second, the supervisor discovered that risk employees and management in general were unaware that claims were too high. This lack of knowledge was due to a lack of benchmarking to other organizations and a historically high claims rate that over time became viewed as the "norm."

Researching the issues further, the supervisor realized that other factors were contributing to the high claims problem. These included part-time risk management; in-house claims adjusting, which focused a disproportionate amount of time on processing of individual claims and very little time on the big picture (that is, whether claims are too high); a corporate culture that viewed claims as a cost of doing business; a decentralized organization that made enforcement of agency-wide policies difficult; an unwillingness of individual supervisors to hold employees accountable for unsafe behavior; and lack of monitoring by top management.

DEVELOPING A STRATEGY

The first step was to attack the culture that helped create the problem. The organization was informed of the benchmarking results and the problem that existed. In addition, a policy decision was made to raise the risk-related premium to the departments to whatever level necessary to eliminate the deficit. Departments were asked to absorb these risk-related increases with no additional funding. Top management also began to incorporate risk-related data into annual performance reviews.

The second step was to change risk management. The risk manager position was reclassified to a full-time position. The mission of risk was also redefined to place a greater emphasis on safety and loss control and less emphasis on processing the paperwork. As part of the new mission, claims adjusting for risk management was outsourced to an outside provider. In-house claims positions were reclassified to safety and loss control. The expertise of the outside adjuster began paying immediate dividends, as the adjuster was able to provide management analysis that helped pinpoint problem areas. The adjuster also adjusted claims quickly and was able to produce more accurate claim reserve estimates.

LESSONS LEARNED: PERFORMANCE IMPROVED

Changing an organization's risk experience is a slow process because it requires behavior throughout the organization to change. In addition, claims often take three to four years or longer to fully develop (pay out). Nevertheless, in the four years since the changes began, the results have been impressive. The actuarial liability for outstanding claims has dropped three years in a row, with a total decrease of 23 percent. Claim payments have also dropped by 14 percent over the period. This, combined with the premium increases, has resulted in a 1997 fund deficit of $1.2 million becoming a 2000 fund surplus of $1.8 million. Within one year, premium reductions to the departments should put risk funding at the lowest level in ten years, in spite of persistent medical and salary inflation and increases in employee count during the period.

Case Study D

Introducing Competition Into the Solid Waste Function of a Local Government

Table of Contents

I. Assumptions and Directions

OBJECTIVE

To assist in working through the process of using competition for an example solid waste function of a local government.

DIRECTIONS

From the assumptions provided in this study, the appropriate example forms, worksheets, and schedules (see chapters 2, 3, 4, and 5) have been completed and used in the decision-making process. Read the following assumptions and trace the information provided to the completed forms, worksheets, and schedules (see exhibits CS-1 through CS-12). The forms, worksheets, and schedules have been organized into the steps involved in introducing competition as follows:

- *Step 1: Qualitative analysis.* Documents the decision about whether introducing competition would likely be successful (see the Competition Profile Forms and the Summary Profile Matrix Form)
- *Step 2: Planning decisions.* Documents whether the project plans, including the performance monitoring plan, the transfer logistics plan, and the personnel plan, support a decision to continue with the project (see the Planning Decision Worksheet)
- *Step 3: Cost analysis.* Documents whether the comparison of in-house relevant costs and outside provider costs indicates adequate cost savings to award a contract to the outside provider. Example schedules used are only those applicable to this case study:
  —Exhibit CS-1, Schedule A
  —Exhibit CS-2, Schedule B
  —Exhibit CS-3, Schedule C
  —Exhibit CS-4, Schedule E
  —Exhibit CS-5, Schedule G
  —Exhibit CS-6, Schedule H
  —Exhibit CS-7, Schedule I
  —Exhibit CS-8, Schedule J
  —Exhibit CS-9, Schedule L
  —Exhibit CS-10, Schedule M
  —Exhibit CS-11, Schedule N
  —Exhibit CS-12, Schedule O
- *Step 4: Recommendation report to evaluation committee.* Documents the conclusion about whether the example government's solid waste service should be contracted out for consideration by the evaluation committee

ASSUMPTIONS

Background

Example Government has been collecting and disposing of solid waste through a Sanitation and Landfill Department since the Government was incorporated. The department has the following employees:

- One department head
- One administrative assistant
- Twelve solid waste collectors
- Two landfill employees

There are a number of qualified outside contractors available to compete for the service. While the quality of service as provided by the department has been satisfactory, competition is being considered from the objective of achieving cost savings of at least 10 percent of relevant operating costs. If contracted out, the Government feels it will retain adequate oversight capability and can easily monitor established performance measures. The risk of contracting out the service is considered quite minimal. While the service delivery is governed by an ordinance, the government anticipates no opposition to amending the ordinance for outside competition. Contracting out the service would have an impact on current employees, but most interested contractors have expressed their desire to hire at least one-half of the current employees. The Government's management and governing body seem to support the introduction of competition in the solid waste service activity; however, the government has historically been slow to make changes. The government will need no significant new resources to introduce competition into this activity.

Reference to Worksheets. The above information is gathered to complete the accompanying qualitative analysis—Competition Profile Forms and the Summary Profile Matrix Form. Upon completion of the forms, the total weighted score amounted to a positive 18. This indicates the solid waste function is an excellent candidate for the introduction of competition and results in a recommendation to proceed. (See pages 193 through 202.)

Personnel Plan Issues

The total current annual payroll for the department's employees, including direct fringe benefits (approximately 20 percent of gross pay), is $437,500. This amount is expected to increase at 5 percent each year over the next three years. The payroll costs can be broken down as follows:

- One department head (annual salary $41,600, hourly rate $20, and vested leave balance of 200 hours)
- One administrative assistant (annual salary $31,200, hourly rate $15, and vested leave balance of 100 hours)
- Twelve solid waste collectors (annual salary $20,800 each, hourly rate $10, and vested leave per employee averages 20 hours)

- Two landfill employees (annual salary $20,800 each, hourly rate $10, and vested leave per employee 20 hours)

Upon termination or separation of service, the department employees will be paid accrued and vested leave balances at their current rate of pay. No other severance pay would result from employee termination. The outside contractor has agreed to employ six of the department's solid waste collectors and both landfill employees. The department head plans to retire if the service is contracted out, the administrative assistant will be reemployed within the government in another position, and the remaining six solid waste workers will have their employment terminated.

Reference to Worksheets. Payroll cost data included in Schedule C (exhibit CS-3), Schedule N (exhibit CS-11), and Schedule O (exhibit CS-12).

Transition Logistics Plan Issues

The following fixed assets are used directly by the department:

- *Four sanitation trucks.* Each costs $100,000, and the trucks, with a useful life of five years, have three years of useful life remaining after the current year.
- *Landfill equipment.* Equipment's total cost is $50,000 and, with a useful life of five years, three years of useful life remain after the current year.

The outside contractor has agreed to buy the four sanitation trucks for a total of $100,000 and all the landfill equipment for $30,000.

Reference to Worksheets. The capital assets cost and disposal information above is included in the accompanying Schedule E (exhibit CS-4) and Schedule M (exhibit CS-10).

No current lease agreements or other contracts will require modification or cancellation. The Government will need no new capital assets or equipment if it contracts out the service.

The outside contractor has agreed to pay the department $20,000 per year for each of the three proposed contract years to lease the landfill. The department will still be responsible for preparing for and implementing landfill closure at the appropriate time, estimated to be in fifteen years. The estimated landfill closure and postclosure costs are $300,000 and are estimated to accrue at a rate of $20,000 per year as the landfill is being used. The department is setting aside the cash in a reserve account to fund the annual accrual each year.

Reference to Worksheets. The lease revenue information above is included as new revenue in Schedule J (exhibit CS-8). The landfill closure costs are considered unavoidable and are included in Schedule G (exhibit CS-5).

Performance Monitoring Plan Issues

The performance of the contractor can be measured with both quantitative and qualitative measures. Quantitative measures include monitoring the cost per solid waste pickup and cost per ton of solid waste disposed. Qualitative measures will include monitoring the consumers' level of service satisfaction through periodic surveys and review of any complaints filed through the government's central complaint office.

Reference to Worksheets. The information provided above regarding the personnel, transfer logistics, and performance monitoring plans is used to complete the accompanying Planning Decision Worksheet and results in the recommendation to continue with the cost comparison phase of the project. (See page 203.)

Additional Cost Comparison Information

For purposes of this case study, it is assumed that the prior (historical) year amounts are the same as the current year. In addition to the personnel and capital depreciation costs noted above, the Department's other current annual operation and maintenance direct costs approximate $100,000. These costs are categorized as follows:

• Insurance	$10,000
• Materials and supplies	60,000
• Repairs and maintenance	20,000
• Telecommunication	1,000
• Utilities	8,000
• Other	1,000

These costs are expected to increase approximately 3 percent each year over the next three years. All of the above other operational direct costs are considered relevant costs.

Reference to Worksheets. The other direct costs are included in the accompanying Schedule G (exhibit CS-5).

Indirect costs allocated to the department for the current year approximate $80,000. The indirect costs have been allocated to the department on a total expenditure basis as follows:

Total indirect costs to be allocated	$1,600,000
Total direct expenditures of government	$13,350,000
Department's direct expenditures	$667,500
Percentage of indirect costs to be allocated	($667,500/$13,350,000) = 5%
Allocated total indirect costs	($1,600,000 x .05) = $80,000

These costs are expected to increase by approximately 4 percent over each of the next three years.

All of these indirect costs are considered unavoidable costs.

Reference to Worksheets. The above indirect cost information is included in the accompanying Schedule H (exhibit CS-6).

The contractor will bill the department a monthly fee of $40,000 ($480,000 annually) for all services related to the collection and disposal of solid waste for the first contract year. The contract cost will increase by 3 percent each year for the remaining two contract years.

Reference to Worksheets. The above outside contractor cost information is included in the accompanying Schedule I (exhibit CS-7).

The department will also incur contract monitoring costs of approximately $3,000 per year related to the internal audit function's periodic and annual performance monitoring activities over this service. This cost is estimated to increase by 5 percent each contract year.

Reference to Worksheets. The above performance monitoring cost information is included in the accompanying Schedule L (exhibit CS-9).

Annually, the solid waste service bills approximately $600,000 in service charges and earns $30,000 in interest on invested funds. No rate increases are anticipated over the next three years due to a management commitment to stabilize costs.

If contracted out, the Government will generate approximately $5,000 for each contract year from new sales tax generated from the contractor's sale of trash containers to customers. No new property tax or franchise tax is expected from the transfer.

Reference to Worksheets. The above new tax revenue information is included in the accompanying Schedule J (exhibit CS-8).

Cost Comparison Conclusion

The information provided above has been used to complete the accompanying Cost Comparison Model Worksheets. The summary results as presented on Schedule A, Summary of Relevant Costs, is used to help make the recommendations on the award of the contract based upon the cost savings objective. The completed Schedule A reflects 14 percent operational cost savings over the three-year contract period. As a result, the recommendation is to consider awarding the contract to the outside contractor from the cost-effectiveness standpoint.

II. Qualitative Analysis

Competiton Profile Forms*

1. Strength of Competitive Market

-3 ____ -2 ____ -1 ____ 0 ____ +1 ____ +2 ____ +3

Low Potential **High Potential**

Definition: Market strength denotes the commercial characteristics of the target function or activity. Outside contractor or provider interest and ability to provide the service are key components.

Questions to Be Considered:

	Yes	No
• Are there multiple capable outside contractors or providers available?	+	–
• Are there multiple interested contractors or providers?	+	–
• Is the nature of the financial commitment so large or small that potential contractors or other providers may not be interested?	–	+
• Will contracting out result in a monopoly?	–	+
• Is the nature of the target function or activity highly complex?	–	+
• Are the current wages in this area, compared to outside providers or other jobs within the entity, causing high personnel turnover?	+	–

Mitigation Suggestions if the Market Strength Does Not Promote Competition:

- Share the responsibility for provision of the service among contractors or between the government or not-for-profit organization and a single contractor.
- Expand the number of contractors to decrease the chance of a monopoly forming.
- Write the request for proposals to ensure multiple contractors and competition exist.
- Determine if long-term contracts can be written to facilitate recoveries of investments for contractors.
- Break down the size of the service into smaller projects. In high-risk services, pilot project contracts may be desirable before full-scale competition is attempted.

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2. Quality of Service

-3__________-2__________-1__________0__________+1__________+2__________+3

Low Potential	**High Potential**

Definition: Quality of service reflects the expected effect privatization will have on the effectiveness, timeliness, and thoroughness, among other factors, of the target function or activity being considered for competition.

Questions to Be Considered:

	Yes	No
• Will quality decrease as a result of contracting out?	–	+
• Will contracting out compromise the public trust, safety, or welfare?	–	+
• Will contracting out threaten patient or client confidentiality or the ability to treat patients or clients with impartiality?	–	+
• Will accountability and responsiveness by the government be decreased by contracting out?	–	+
• Can well-defined objectives be included in a contract?	+	–

Mitigation Suggestions if the Quality of Service Profile Does Not Promote Competition:

- The agency can place more emphasis on oversight for quality control.
- Include formal periodic customer ratings of the contractor's performance.
- Build in incentives to providers for quality service.

3. Control

-3	-2	-1	0	+1	+2	+3
Low Potential						**High Potential**

Definition: Control considers the government or not-for-profit organization's ability to oversee the provision of the target function or activity.

Questions to Be Considered:

Question	Yes	No
• Is it important for the agency to control the delivery of the target function or activity?	–	+
• Does the agency have the ability to develop and maintain control mechanisms over the target function or activity if it is privatized?	+	–
• Is the quality and quantity of the target function or activity service relatively easy to measure?	+	–

Mitigation Suggestions if the Control Profile Does Not Promote Competition:

- Increase control through detailed contract specifications.
- Require that the contractor maintain records that allow easy oversight and evaluation.
- Teach contract writing, management, and evaluation skills to employees charged with control, oversight, and monitoring.
- Develop a thorough monitoring plan before implementing the request for proposals and contract award phases.

4. Risk

-3 ____ -2 ____ -1 ____ 0 ____ +1 ____ +2 ____ +3

Low Potential | **High Potential**

Definition: Risk is the degree to which using outside contractors exposes the government or not-for-profit organization to additional hazards, including legal or financial exposure, service disruption, corruption, and other risk factors.

Questions to Be Considered:

	Yes	No
• Are the chances high that the contractor(s) will fail to complete the contract(s)?	–	+
• Will the consequences of any service interruptions be major?	–	+
• Will there be increased legal exposure as a result of contracting out?	–	+
• Will contracting out result in an increased risk of corruption?	–	+
• Will contracting out result in sharing risk with the contractor?	+	–
• Will the contractor be able to indemnify the agency?	+	–
• Will the contractor be singularly responsible for any and all cost overruns?	+	–

Mitigation Suggestions if the Risk Profile Does Not Promote Competition:

- Write contract provisions to reduce the risk of service interruption, by including reporting requirements and/or liquidated damage clauses.
- Maintain ownership of capital equipment.
- Develop an emergency plan to deal with interruption of service.
- Rent critical equipment and facilities to the outside contractor.
- Maintain a list of alternative providers.
- Slowly phase in privatization until it is certain that contractors are capable and reliable.
- Include cost adjustments into the contract for inflation and increased service requirements.

5. Legal Barriers

-3__________-2__________-1__________0__________+1__________+2__________+3

Low Potential	**High Potential**

Definition: Legal barriers include the effect that any laws, regulations, or other contractual requirements may have on a decision to introduce competition into the target function or activity.

Questions to Be Considered:

	Yes	No
• Is the mode of service delivery mandated by law, regulation, or contract?	–	+
• Must laws or rules be changed to permit outsourcing of the target function or activity?	–	+
• Is outsourcing compatible with the legislative, commission, or board intent that created the target function or activity?	+	–

Mitigation Suggestions if the Legal Barriers Profile Does Not Promote Competition:

- If the scale is tipped away from competing, the legal limits may relate to only small portions of the target function or activity that might be separated from the privatization portion.
- If laws need to be changed, assess the difficulty of doing so. Is the legislative climate conducive to supporting change? Are there sponsors willing to support needed legislation?

6. Political Resistance

-3__________-2__________-1__________0__________+1__________+2__________+3

Low Potential — **High Potential**

Definition: Political resistance anticipates the amount of opposition to change in who provides the target function or activity service. This resistance can come from the public, users of the target function or activity, interest groups, or public officials.

Questions to Be Considered:

	Yes	No
• Are concerned citizens, service recipients, interest groups, public/elected officials, or board members highly resistant to change?	−	+
• Do citizens, service recipients, interest groups, or public/elected officials or board members want the service to be provided in-house?	−	+
• Does the target function or activity have low overall political support?	+	−
• Are there any current problems with in-house delivery?	+	−

Mitigation Suggestions if the Political Environment Does Not Promote Competition:

- Reduce resistance by designing compromises in contracts or agreements.
- Reschedule implementation until a better time of year or date to avoid the resistance.
- Focus on services that the government or not-for-profit organization is not satisfactorily providing.
- Involve various interested groups in the decision-making process.

7. Impact on Employees

-3__________-2__________-1__________0__________+1__________+2__________+3

Low Potential | **High Potential**

Definition: The impact on public employees considers the effect that introducing competition into the target function or activity will have on the government or not-for-profit organization's employees.

Questions to Be Considered:

	Yes	No
• Will contracting out negatively affect employees?	–	+
• Will a large number of employees be affected?	–	+
• Will the contractors be required to hire displaced employees?	+	–
• Will any employees choose buy-out options?	+	–
• Will any employees be involuntarily terminated?	–	+
• Will civil service policies, such as affirmative action, be weakened as a result of outsourcing?	–	+

Mitigation Suggestions if the Impact on Employees Profile Does Not Promote Competition:

- Provide job transfers into other employment opportunities.
- Provisions can be written into contracts that ensure that some civil service policies, such as affirmative action and due process, are carried out by the provider.
- Include a provision in the contract to ensure that the contractor gives displaced employees that right-of-first refusal.
- Provide employees with early retirement options.

8. Resources

-3 ____ -2 ____ -1 ____ 0 ____ +1 ____ +2 ____ +3

Low Potential **High Potential**

Definition: Resources reflect the efficient and effective use of government assets (for example, personnel and funding). This includes in-house or private sector advantages in terms of professional expertise, facilities or equipment, time constraints, and state revenue or expenditure restrictions.

Questions to Be Considered:

	Yes	No
• Do the competitors have access to needed expertise that the government or not-for-profit organization does not?	+	–
• Do the competitors possess needed facilities or equipment that the government or not-for-profit organization does not?	+	–
• Are there other resource advantages that the competitors have that the government or not-for-profit organization does not?	+	–
• Do time constraints exist that preclude in-house delivery?	+	–
• Will contracting out reduce required completion times?	+	–

Mitigation Suggestions if the Resource Profile Does Not Promote Competition:

- In cases where the government or not-for-profit organization has substantial equipment and facilities, examine whether selling or leasing is an option.
- Lease purchase agreements might be used so that the entity eventually takes ownership of the resources.
- Resources might be shared among departments for greater efficiency. For example, can departments share a privately provided printing service and save money?
- Better planning by the entity may help to avoid resource inefficiencies.

Summary Profile Matrix

Profile Factor	Low Potential for Competition (Pro In-House)			High Potential for Competition (Pro Outside)			Relative Importance Weight 1=Low 4=High	Weighted Score
1. Strength of competitive market	−3	−2	−1	+1	+2	+3	2	6
2. Quality of service	−3	−2	−1	+1	+2	+3	3	6
3. Control	−3	−2	−1	+1	+2	+3	2	6
4. Risk	−3	−2	−1	+1	+2	+3	1	3
5. Legal barriers	−3	−2	−1	+1	+2	+3	1	2
6. Political resistance	−3	−2	−1	+1	+2	+3	4	4
7. Impact on employees	−3	−2	−1	+1	+2	+3	3	−3
8. Resources	−3	−2	−1	+1	+2	+3	2	−6
Total weighted score								**18**

Summary Profile Matrix *(continued)*

COMMENTS OR RATIONALE:

With a positive overall weighted score of 18, the solid waste function is a clear candidate for the successful introduction of competition. The negative factors of impact on employees and resources are mitigated by the strength of the other profile factors.

III. Planning Decisions

Target Function: Solid Waste Function **Date:** 10/01/20XX

1. Does the qualitative analysis support the decision to compete the target function or activity? *Yes. Total weighted score was a positive 18, indicating a strong candidate for competition.*
2. Has the project scope been defined and are specific deliverables capable of being provided by interested outside contractors? *Yes. Project scope of services is not complex and is routinely provided by private contractors.*
3. Does the service delivery strategy selected meet both the present and future needs of the customer? *Yes. The customer is likely to notice no significant changes in the service presently or in the future.*
4. Does the performance monitoring plan indicate that effective performance measuring and monitoring is capable and likely to result in data that will assist in determining cost savings and customer satisfaction? *Yes. Both quantitative and qualitative measures can be monitored. Quantitative would include cost per pickup and cost per ton disposed. Qualitative would measure customer satisfaction through our complaint office or periodic customer surveys.*
5. Does the transition logistics plan accomplish, in a realistic manner, a smooth transition of service delivery with a minimum of inconvenience to customers? *Yes. No problems anticipated in transition.*
6. Does the personnel plan minimize employee disruption, result in a fair and equitable treatment of employees, and sufficiently identify personnel transition costs? *No. Most outside contractors have stated they will employ only up to one-half of our current employees. The remaining employees will have their employment terminated. Personnel conversion costs are not considered significant.*
7. Have stakeholders' concerns been sufficiently addressed and will the project likely garner their support? *Yes. There is no major opposition to contracting out the solid waste function. The only negative feedback relates to the planned displacement of some of the current employees.*

CONTINUATION DECISION

Should the competition task team continue with the project of introducing competition into this target function or activity? YES X NO ____

IV. Cost Analysis

Exhibit CS-1

Schedule A: Summary of Relevant Costs*

AGENCY: Example Government TARGET ACTIVITY: Solid Waste DATE: xx-xx-xx

	Review Periods' Relevant Costs					
Cost Category	**Historical Year**	**Current Year**	**A Contract Period 1**	**B Contract Period 2**	**C Contract Period 3**	**Contract Period Total (Columns A+B+C)**
In-house delivery						
A. Relevant direct costs (Schedule B)	$500,000	$500,000	$ 523,000	$547,210	$572,700	**$1,642,910**
B. Relevant indirect costs (Schedule H)	0	0	0	0	0	**0**
C. Adjustments	0	0	0	0	0	**0**
D. Total relevant in-house costs (Lines A+B+C)	**$500,000**	**$500,000**	**$ 523,000**	**$547,210**	**$572,700**	**$1,642,910**
Outside delivery						
E. Contractor costs (Schedule I)			$ 455,000	$469,400	$484,240	**$1,408,640**
F. Contractor support costs (Schedule K)			0	0	0	**0**
G. Contractor monitoring costs (Schedule L)			3,000	3,150	3,310	**9,460**
H. Total contractor operating costs (Lines E+F+G)			**$ 458,000**	**$472,550**	**$487,550**	**$1,418,100**
I. Net proceeds—from asset conversions (Schedule M)			(130,000)	0	0	**(130,000)**
J. Conversion costs (Schedule N)			7,825	0	0	**7,825**
K. Total one-time costs (proceeds) (Lines I+J)			**$(122,175)**	**$ 0**	**$ 0**	**$ (122,175)**
L. Total outside costs (Lines K+H)			**$ 335,825**	**$472,550**	**$487,550**	**$1,295,925**
Operating cost savings (Line D total less Line H total) If positive and 10 percent (a) or more of Line D, continue below						**$224,810 or 14%**
Total relevant cost savings (Is total Column of Line L less than total Column of Line D?) If yes, consider awarding to outside provider.						**$346,985/Yes**

Footnotes:

(a) In this example, the 10 percent desired savings represents the minimum level of operational cost savings required for the entity to further consider contracting out. This desired savings percentage is a matter of policy and should be addressed by each entity considering introducing competition.

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Exhibit CS-2

Schedule B: Summary of Relevant Direct Costs*

AGENCY: Example Government

TARGET ACTIVITY: Solid Waste

Cost Category	A Historical Year	B Current Year	C Contract Period 1	D Contract Period 2	E Contract Period 3	F Contract Total (b)
	Review Periods' Relevant Costs (a)					
A. Personnel (Schedule C)	$400,000	$400,000	$420,000	$441,000	$463,050	$1,324,050
B. New capital assets (Schedule D)	0	0	0	0	0	$ 0
C. Depreciation—New capitalized assets (Schedule D)	0	0	0	0	0	$ 0
D. Lease/rental (Schedule F)	0	0	0	0	0	$ 0
E. Other direct costs (Schedule G)	100,000	100,000	103,000	106,210	109,650	$ 318,860
Total (c)	$500,000	$500,000	$523,000	$547,210	$572,700	$1,642,910

Footnotes:

(a) This schedule includes only "relevant" direct costs of the target activity. (See table 4.1 in chapter 4 for definitions of both relevant and direct costs.)

(b) Total relevant direct costs for the proposed contract period, the sum of columns C, D and E. In this example, contract period is three years.

(c) Represents total relevant direct costs of the target activity for each review period. Enter on Schedule A, Line A (exhibit CS-1).

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Exhibit CS-3

Schedule C: Personnel Costs*

AGENCY: Example Government   TARGET ACTIVITY: Solid Waste

Part 1: Current Year Relevant Costs

A Position Title	B Number of Full-time Equivalent Positions	C Average Annual Salary/Wage	D Total Annual Salary/Wage (B x C)	E Fringe Benefits (rounded) (D x 0.20)	F Total Personnel Costs (D+E)
Department head	1	$41,600	$ 41,600	$ 8,400	$ 50,000
Administrative assistant (a)	1	31,200	31,200	6,300	37,500
Solid waste collectors	12	20,800	249,600	50,400	300,000
Landfill workers	2	20,800	41,600	8,400	50,000
			Total direct personnel costs		$437,500
			Less: Unavoidable costs (a)		$ (37,500)
			Total relevant costs (b)		$400,000

Part 2: Review Period Relevant Costs (c)

Historical Year (d)	Current Year (e)	Contract Period 1 (f)	Contract Period 2 (f)	Contract Period 3 (f)	Contract Periods Total
$400,000	$400,000	$420,000	$441,000	$463,050	$1,324,050

Footnotes:

(a) Unavoidable costs, as defined in table 4.1 (see chapter 4), are subtracted from the total direct personnel costs to determine relevant costs. In this example, all employee positions of the target activity will be eliminated if the activity is contracted out, except for the administrative assistant position. Therefore, the costs associated with the assistant are unavoidable direct personnel costs.

(b) Relevant costs, as defined in table 4.1, are avoidable costs. In this example, the avoidable direct personnel costs are related to the employee positions that will no longer remain if the target activity is contracted out.

(c) The review period relevant costs in part 2 will be carried forward to Schedule B, Line A (exhibit CS-2).

(d) Relevant direct personnel costs of the target activity were obtained from prior year accounting records.

(e) Current year relevant direct personnel costs as calculated in part 1 above.

(f) Contract period costs are calculated, in this example, as a 5% increase each year from the previous period or year.

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Exhibit CS-4

Schedule E: Depreciation Cost for Current Capital Assets*

AGENCY: Example Government   TARGET ACTIVITY: Solid Waste

Purchase Date	A Description of Asset Item	B Purchase Price	C Improvements Capitalized	D Salvage Value	E Depreciation Base (Columns B+C)−D	F Useful Life (years)	G If Not Fully Depreciated: Annual Depreciation Cost (Column E/Column F)
xx-xx-xx	Four sanitation trucks (a)	$400,000	$0	$0	$400,000	5	$ 80,000
xx-xx-xx	Landfill equipment (a)	$ 50,000	$0	$0	$ 50,000	5	10,000
				Total costs			$ 90,000
				Less: Unavoidable sunk costs (a)			$(90,000)
				Relevant costs (b)			$ 0

Footnotes:

(a) In this example, all four trucks and the landfill equipment (all capital assets used by the target activity) will be sold to the outside contractor. The annual depreciation costs for these assets are considered a sunk and unavoidable cost.

(b) Under the approach used in this publication, depreciation costs on all current capital assets, regardless of disposition, are not considered relevant.

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Exhibit CS-5

Schedule G: Other Direct Costs*

AGENCY: Example Government

TARGET ACTIVITY: Solid Waste

	Review Periods									
	Historical		Current Year		Contract Period 1		Contract Period 2		Contract Period 3	
Cost Category	Total	Relevant	Total	Relevant	Total	Relevant	Total	Relevant	Total	Relevant
Insurance	$ 10,000	$ 10,000	$ 10,000	$ 10,000	$ 10,300	$ 10,300	$ 10,600	$ 10,600	$ 11,000	$ 11,000
Materials and supplies	$ 60,000	$ 60,000	$ 60,000	$ 60,000	$ 61,800	$ 61,800	$ 63,700	$ 63,700	$ 65,700	$ 65,700
Repairs and maintenance	$ 20,000	$ 20,000	$ 20,000	$ 20,000	$ 20,600	$ 20,600	$ 21,300	$ 21,300	$ 22,000	$ 22,000
Telecommunications	$ 1,000	$ 1,000	$ 1,000	$ 1,000	$ 1,030	$ 1,030	$ 1,060	$ 1,060	$ 1,100	$ 1,100
Travel	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
Utilities	$ 8,000	$ 8,000	$ 8,000	$ 8,000	$ 8,240	$ 8,240	$ 8,490	$ 8,490	$ 8,750	$ 8,750
Other	$ 1,000	$ 1,000	$ 1,000	$ 1,000	$ 1,030	$ 1,030	$ 1,060	$ 1,060	$ 1,100	$ 1,100
Landfill closure amortization (a)	$ 20,000	$ 0	$ 20,000	$ 0	$ 20,000	$ 0	$ 20,000	$ 0	$ 20,000	$ 0
Total (b)	$120,000	$100,000	$120,000	$100,000	$123,000	$103,000	$126,210	$106,210	$129,650	$109,650

Footnotes:

(a) Per case study assumptions, these costs are considered unavoidable and therefore are not included as relevant costs.

(b) Enter relevant costs in appropriate period on Schedule B, Line F (exhibit CS-2).

Note: Per case study assumptions, a 3% annual cost increase is anticipated after the current year.

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Exhibit CS-6

Schedule H: Summary of Relevant Indirect Costs*

AGENCY: Example Government TARGET ACTIVITY: Solid Waste

	Review Periods									
	Historical		Current Year		Contract Period 1		Contract Period 2		Contract Period 3	
Indirect Cost Category	**Total**	**Relevant**	**Total**	**Relevant**	**Total**	**Relevant**	**Total**	**Relevant**	**Total**	**Relevant**
Total Allocated Indirect Costs	$80,000	$0	$80,000	$0	$83,200	$0	$86,600	$0	$90,100	$0
Total (a)	$80,000	$0	$80,000	$0	$83,200	$0	$86,600	$0	$90,100	$0

Footnotes:

(a) Enter total relevant costs in appropriate period on Schedule A, Line B (exhibit CS-1). In this case, all allocated indirect costs are considered unavoidable. As a result, there are no relevant indirect costs.

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Exhibit CS-7

Schedule I: Contractor Costs*

AGENCY: Example Government

TARGET ACTIVITY: Solid Waste

	Contract Period 1	Contract Period 2	Contract Period 3
A. Contract price (a)	$480,000	$494,400	$509,240
B. Decrease in user fees (b)	0	0	0
C. Lost grants or subsidies (b)	0	0	0
D. Other contractor costs (b)	0	0	0
E. Subtotal (A+B+C+D)	$480,000	$494,400	$509,240
F. Credit for new revenues (c)	$ (25,000)	$ (25,000)	$ (25,000)
G. Total net contractor cost (d) (E-F)	$455,000	$469,400	$484,240

Footnotes:

(a) Per case study assumptions, first year contract price of $480,000 and a 3% annual increase in contract price each year.
(b) Calculation of any loss of revenue or other contractor costs anticipated from contracting out. None anticipated in this case.
(c) Anticipated new revenue resulting from contracting with an outside provider. Total carried forward from Schedule J (exhibit CS-8).
(d) Enter total net contractor costs on Schedule A, Line E (exhibit CS-1).

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Exhibit CS-8

Schedule J: New Revenue Generated*

AGENCY: Example Government

TARGET ACTIVITY: Solid Waste

	Contract Period 1	Contract Period 2	Contract Period 3
New tax revenue (a)	$ 5,000	$ 5,000	$ 5,000
Other new revenues:			
Landfill lease revenue (b)	$20,000	$20,000	$20,000
Total new revenues (c)	$25,000	$25,000	$25,000

Footnotes:

(a) Calculation of estimated new sales tax revenue to be generated from contracting out over the contract period. In this case, the same amount of new tax is estimated annually for the three-year contract period.

(b) Calculation of estimated other, nontax revenues to be generated from contracting out. In this case, the contractor has agreed to lease the landfill for $20,000 per year over the contract period.

(c) Total of anticipated new revenue generated. Enter on Contractor Costs Schedule I, Line F (exhibit CS-7).

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Exhibit CS-9

Schedule L: Contractor Monitoring Costs*

AGENCY: Example Government

TARGET ACTIVITY: Solid Waste

	Contract Period 1	Contract Period 2	Contract Period 3
Personnel costs of monitoring staff: (a)			
Salaries and wages	$ 0	$ 0	$ 0
Benefits	0	0	0
Other monitoring costs: (a)			
Internal audit charges	3,000	3,150	3,310
Total contractor monitoring costs (b)	$3,000	$3,150	$3,310

Footnotes:

(a) Assumes 5 percent annual increase in internal audit costs over the contract period.

(b) Enter total contractor monitoring costs in appropriate periods on Schedule A, Line G (exhibit CS-1).

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Exhibit CS-10

Schedule M: Revenue Generated From Asset Conversions*

AGENCY: Example Government

TARGET ACTIVITY: Solid Waste

Description of Assets	A Disposition Gross Proceeds (a)	B Disposal Cost (b)	C Net Proceeds (Columns A-B)
Four trucks	$100,000	0	$100,000
Landfill equipment	30,000	0	30,000
Total (c)	$130,000	0	$130,000

Footnotes:

(a) Proceeds from sale or disposition of assets. In this case, the assets will be sold to the outside contractor for $130,000, $100,000 for the four trucks and $30,000 for the landfill equipment.

(b) Any costs anticipated to be incurred in selling or disposing of the assets, such as advertising costs. In this case, there are no disposal costs since the outside contractor has agreed to buy the assets.

(c) Enter the total net proceeds in the contract period the proceeds will be received on Schedule A, Line 1 (exhibit CS-1). In this case, the total net proceeds will be received in contract period 1.

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Exhibit CS-11

Schedule N: Conversion Costs*

AGENCY: Example Government

TARGET ACTIVITY: Solid Waste

Category	Cost
Personal conversion costs (a)	$7,825
Additional conversion costs:	
Total (b)	$7,825

Footnotes:

(a) One-time costs related to personnel terminations or other changes resulting from contracting out. This total amount is carried forward from Schedule O (exhibit CS-12).

(b) Enter total conversion costs in the contract period they will be paid on Schedule A, Line J (exhibit CS-1). In this case, the total conversion costs will be paid in contract period 1.

* Source: Adapted from the State of Arizona *Competitive Government Program Handbook*, July 2000, Governor's Office of Excellence in Government. This form is included for your convenience and information only. Periodically, the state updates or changes the forms that were adapted for this publication. You should check the Arizona Web site (www.governor.state.az.us/excellence) if you have an interest in any updates that the state may have made to the forms since this publication was issued.

Exh. CS-12

Schedule O: Personnel Conversion Cost*

AGENCY: Example Government TARGET ACTIVITY: Solid Waste

Positions	A Average Hourly Wage	B Vested Leave Balance (Hours)	C Vested Leave Costs (Columns A x B)	D Severance Pay	E Medicare & FICA (a)	F Retirement (a)	G Unemployment (a)	H Other	I Total
Department head (b)	$20	200	$4,000	$0	$360	$200	$40	$0	$4,600
Twelve waste collectors (b)	$10	240	$2,400	$0	$220	$120	$20	$0	$2,760
Two landfill workers (b)	$10	40	$ 400	$0	$ 40	$ 20	$ 5	$0	$ 465
								Total (c)	$7,825

Footnotes:

(a) Calculation of fringe benefit costs associated with the personnel conversion pay in Columns C and D.

(b) Employees no longer employed as a result of contracting out. In this case, all employees except the administrative assistant will no longer be employed by the government.

(c) Enter total in the personnel conversion costs line on Schedule N (exhibit CS-11).

* Source: Adapted from the State of Arizona *Competitive Government Program Handbook*, July 2000, Governor's Office of Excellence in Government. This form is included for your convenience and information only. Periodically, the state updates or changes the forms that were adapted for this publication. You should check the Arizona Web site (www.governor.state.az.us/excellence) if you have an interest in any updates that the state may have made to the forms since this publication was issued.

V. Recommendation Report to Evaluation Committee on Outsourcing the Solid Waste Service

To: Competition Evaluation Committee

From: Competition Task Team

Date: xx-xx-xxxx

BACKGROUND

During the past year, the Example Government competition task team has been working to introduce competition into the solid waste collection and disposal service of the government. This is the first attempt to consider outside contracting for the solid waste service since the government has been providing this service. The competition process involved the following:

- *A qualitative analysis.* This analysis evaluated certain criteria to determine whether the solid waste function would be an excellent candidate for the introduction of competition.
- *Competition planning.* This phase involved the development of three plans, performance monitoring plan, personnel plan, and transfer logistics plan, which will be used in contracting the service.
- *Cost analysis.* A request for proposal was prepared and submitted to various interested contractors. Five proposals were received and evaluated. The contractor with the best offer was selected for comparison of outside costs to our relevant in-house costs to determine whether contracting out would be cost beneficial.

RESULTS AND FINANCIAL IMPACT

The results of the competition process are highlighted below.

- The qualitative analysis resulted in a positive weighted score of 18. Any positive weighted score indicates a good candidate for the introduction of competition. A score of positive 18 indicates the solid waste function is considered an excellent candidate for considering competition.
- The performance monitoring plan indicates that effective performance measuring and monitoring is capable and likely to result in data that will assist in determining cost savings and customer satisfaction. Both quantitative and qualitative measures can be monitored. Quantitative measures will include cost per pickup and cost per ton disposed. Qualitative measures will measure customer satisfaction through our complaint office or periodic customer surveys.

- The transfer logistics plan indicates we can accomplish, in a realistic manner, a smooth transition of service delivery with a minimum of inconvenience to customers.
- The personnel plan minimizes employee disruption to the extent possible, results in a fair and equitable treatment of employees, and sufficiently identifies the personnel transition costs. The selected outside contractor has indicated they will employ at least one-half of our current employees. One-time payroll transition costs, at less than $8,000, are not considered significant.
- The cost analysis comparing in-house relevant costs to the outside contracting costs indicates that over the three-year contract period, relevant cost savings would approximate $346,985, and operating costs savings would approximate $224,810, or 14 percent of in-house relevant costs.

RECOMMENDATION

The results and financial impact above indicate that contracting out the solid waste collection and disposal service can be cost-effective and efficient. The competition task team recommends that the Example Government proceed with the development of a formal contract with the selected outside contractor and submission of the final contract for approval at the next meeting.

Chapter 7:

Associations, Organizations, Agencies and Other Resources

This chapter presents associations, organizations, agencies, publications, studies, reports, and other sources that can provide valuable information on the various aspects of using competition in government and not-for-profit organizations.

ASSOCIATIONS, ORGANIZATIONS, AND AGENCIES

The following associations, organizations, and agencies represent groups with paid membership and/or volunteers with internal and/or external resources that can address issues and questions regarding the use of competition in government and not-for-profit organizations.

American Institute of Certified Public Accountants

The AICPA is the national, professional organization for all certified public accountants. Its mission is to provide members with the resources, information, and leadership that enable them to provide valuable services in the highest professional manner to benefit the public as well as employers and clients.

With more than 330,000 members, the AICPA is the premier national professional association for CPAs in the United States. The AICPA, in addition to the various state CPA societies, has useful research and educational information to assist CPAs in the conduct of their services.

Following is contact information:

American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775
Telephone: (888) 777-7707
Fax: (212) 596-6213
Web site: www.aicpa.org

Association of Government Accountants

The Association of Governmental Accountants (AGA) is the national, professional educational organization dedicated to the enhancement of public financial management. The AGA conducts independent research and analysis of all aspects of governmental financial management, including cost of service analysis, performance measurement, and privatization.

Following is contact information:

Association of Government Accountants
2208 Mount Vernon Avenue
Alexandria, VA 22301
Telephone: (703) 684-6931 or (800) AGA-7211
Fax: (703) 548-9367
Web site: www.agacgfm.org

Government Finance Officers Association

The Government Finance Officers Association (GFOA) is the professional association of state/provincial and local finance officers in the United States and Canada, and it has served the public finance profession since 1906. The association's 14,100 members are dedicated to the sound management of government financial resources. The GFOA provides various resource material dealing with privatization, cost accounting, and performance measurement for both state and local governments.

Following is contact information:

Government Finance Officers Association
180 N. Michigan Ave., Suite 800
Chicago, IL 60601
Telephone: (312) 977-9700
Fax: (312) 977-4806
Web site: www.gfoa.org

Governmental Accounting Standards Board

The mission of the Governmental Accounting Standards Board (GASB) is to establish and improve standards of state and local government accounting and financial reporting that will result in useful information for users of financial reports and guide and educate the public, including issuers, auditors, and users of those financial reports. The GASB provides useful guidance and documented examples of performance measurement in the activities of state and local governments.

Following is contact information:

Governmental Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116
Telephone: (203) 847-0700 or (800) 748-0659
Fax: (203) 849-9714
Web site: www.gasb.org

U.S. General Accounting Office

The U.S. General Accounting Office (GAO) has conducted certain studies and issued reports dealing with privatization and performance measurement.

Following is contact information:

U.S. General Accounting Office
441 G Street, N.W.
Washington, DC 20548
Telephone: (202) 512-6000
Fax: (301) 258-4066
Web site: www.gao.gov

National Association of College & University Business Officers

The National Association of College & University Business Officers (NACUBO) is an association of colleges and universities, including government-owned and not-for-profit institutions, that provide, among other things, information on performance enhancement activities of colleges and universities.

Following is contact information:

National Association of College and University Business Officers
2501 M Street, NW, Suite 400
Washington, DC 20037
Telephone: (202) 861-2500
Fax: (202) 861-2583
Web site: www.nacubo.org

Institute of Management Accountants

The Institute of Management Accountants (IMA) is a professional organization devoted exclusively to management accounting and financial management. The IMA provides useful research reports and educational materials related to cost accounting and analysis and the use of accounting information for making management decisions.

Following is contact information:

Institute of Management Accountants
10 Paragon Drive
Montvale, NJ 07645-1718
Telephone: (800) 638-4427
Fax: (201) 573-0559
Web site: www.imanet.org

Institute of Internal Auditors (IIA)

The Institute of Internal Auditors (IIA) is a professional organization servicing over 70,000 members in internal auditing, governance, and internal control; information technology auditing; education; and security. The IIA provides useful research reports, best practices, and educational materials related to both financial and performance internal auditing.

Following is contact information:

Institute of Internal Auditors
249 Maitland Avenue
Altamonte Springs, FL 32701-4201
Telephone: (407) 830-7600
Fax: (407) 831-5171
Web site: www.theiia.org

International City/County Management Association

The International City/County Management Association (ICMA) is a professional and educational organization representing appointed managers and administrators in local governments throughout the world. The ICMA provides resource material and documented examples of privatization and performance measurement in city and county governments.

Following is contact information:

The International City/County Management Association
777 North Capitol Street, NE
Suite 500
Washington, DC 20002
Telephone: (202) 289-4262
Fax: (202) 962-3500
Web site: www.icma.org

National Association of State Auditors, Comptrollers and Treasurers

The National Association of State Auditors, Comptrollers and Treasurers (NASACT) is a professional organization devoted to representing the states' views on a variety of financial management topics. The NASACT provides useful information and resources related to improving financial management and performance in state governments.

Following is contact information:

National Association of State Auditors, Comptrollers and Treasurers
2401 Regency Road
Suite 302
Lexington, KY 40503-2914
Telephone: (859) 276-1147
Fax: (859) 278-0507
Web site: www.sso.org

The Reason Foundation

The Reason Foundation is a national research and education organization that explores and promotes public policies based on rationality and freedom. The Foundation's Web site includes, in the Policy Research section, reference to a number of publications, studies, and other information related to privatization of government and not-for-profit services.

Following is contact information:

Reason Foundation
3415 S. Sepulveda Blvd.
Suite 400
Los Angeles, CA 90034
Telephone: (310) 391-2245
Fax: (310) 391-4395
Web site: www.reason.org

Governments Active in Introducing Competition

This section provides a listing of many of the state and local governments that provide useful information for practitioners in introducing competition. Each listing provides the Web address.

City of Indianapolis, IA
The Competition Initiative
www.indygov.org

City of Phoenix, AZ
Public-Private Competitive Proposal Process
www.ci.phoenix.az.us

City of Portland, OR
Competitive Contracting—Auditor Report No. 179
www.ci.portland.or.us/auditor
To download report only: www.ci.portland.or.us/auditor/audser/pdfs/179.pdf

State of Arizona
Office for Excellence in Government
Competitive Government Program
www.governor.state.az.us/excellence/competitive_government.htm
(Automated cost model forms available from this Web site for Excel and Quattro Pro)

State of Colorado
Colorado State Government Privatization Commission
www.state.co.us/gov_dir/gss/edo/priv/index.htm

State of Kansas
Kansas Performance Review Board Program
http://members.parod.com/kprb

State of Michigan
Michigan Public-Private Partnership Commission
www.state.mi.us/stategovernment.shtm

State of Texas
State Council of Competitive Government
www.ccg.state.tx.us/

State of Virginia
Commonwealth Competition Council
www.vipnet.org/ccc

PUBLICATIONS

This section lists numerous publications, organized by topic, relevant to using competition.

Activity-Based Costing and Activity-Based Management

Brimson, James A., and John Antos. *Activity-Based Management: For Service Industries, Government Entities, and Nonprofit Organizations.* New York: John Wiley & Sons, Inc., 1999.

Hicks, Douglas T. *Activity-Based Costing: Making It Work for Small and Mid-Sized Companies,* 2d ed. New York: John Wiley & Sons, Inc., 1999.

Weiss, Barbara. *Activity-Based Costing and Management: Issues and Practices in Local Government.* Chicago: Government Finance Officers Association, 1997.

White, Timothy S. *The 60-Minute ABC Book: Activity-Based Costing for Operations Management.* Bedford, Tex.: CAM-I, 1997.

Outsourcing

Benaud, Claire-Lise, and Sever Bordeianu. *Outsourcing Library Operations in Academic Libraries: An Overview of Issues and Outcomes.* Englewood, Colo.: Libraries Unlimited, 1998.

Bendor-Samuel, Peter. *Turning Lead Into Gold: The Demystification of Outsourcing.* Provo, Utah: Executive Excellence, 2000.

Bragg, Steven, M. *Outsourcing: A Guide to . . . Selecting the Correct Business Unit . . . Negotiating the Contract . . . Maintaining Control of the Process.* New York: John Wiley & Sons, Inc., 1998.

Burnett, Rachel, *Outsourcing IT: The Legal Contract.* Aldershot, Hampshire: Gower Publishing Co., 1998.

Butler, Janet. *Winning the Outsourcing Game: Making the Best Deals and Making Them Work.* Boca Raton, Fla.: Auerbach Publishers, Inc., 2000.

Caruso, Lane S. *Selecting and Managing an Outsourcing Provider.* Scottsdale, Ariz.: WorldatWork, 1997.

Chapman, Robert B, Robert E. Chapman, and Kathleen R. Andrade. *Insourcing After the Outsourcing: MIS Survival Guide.* New York: AMACOM, 1997.

Cook, Mary, F. *Outsourcing Human Resources Functions: Strategies for Providing Enhanced HR Services at Lower Cost.* New York: AMACOM, 1998.

Currie, Wendy, and Robert Galliers, eds. *Rethinking Management Information Systems: An Interdisciplinary Perspective.* New York: Oxford University Press, 1998.

De Looff, L. A. *Information Systems Outsourcing Decision Making: A Managerial Approach.* Series in Information Technology. Hershey, Penn.: Idea Group, 1996.

KPMG Peat Marwick LLP & G2R, Inc. Staff. *A Case-Study Guide to Business Process Outsourcing.* Morristown, N.J.: Financial Executives Research Foundation, 1998.

Domberger, Simon. *The Contracting Organization: A Strategic Guide to Outsourcing.* New York: Oxford University Press, 1999.

The Economist Intelligence Unit. *Vision 2010: Forging Tomorrow's Public-Private Partnerships.* Economist Intelligence Unit, 1999.

Frenza, J.P. *Buying Web Services: The Survival Guide to Outsourcing.* New York: John Wiley & Sons, Inc., 1998.

Gay, Charles, L. and James Essinger. *Inside Outsourcing: The Secrets of Strategic Sourcing.* London: Nicholas Brealy Publishing, Ltd., 2000.

Goetz, Philip. *ASP: Healthcare Application Service Provider.* TRB Solutions, Inc., 1998.

Greaver, Maurice F. *Strategic Outsourcing: Risk Management, Methods and Benefits.* New York: AMACOM, 1998.

Halvey, John K., and Barbara Murphy Melby. *Business Process Outsourcing: Process, Strategies, and Contracts.* New York: John Wiley & Sons, Inc., 1999.

Halvey, John K., Barbara Murphy Melby, and John H. Halvey. *Information Technology Outsourcing Transactions: Process, Strategies, and Contracts.* New York: John Wiley & Sons, Inc., 1996.

Hirshon, Arnold, and Barbara Winters. *Outsourcing Library Technical Services: A How-to-Do-It Manual for Librarians.* New York: Neal Schuman, 1996.

Johnson, Mike. *Outsourcing In Brief.* Woburn, Mass.: Butterworth-Heinemann, 1997.

Kascus, Marie A., and Dawn Hale, eds. *Outsourcing Cataloging, Authority Work, and Physical Processing: A Checklist of Considerations.* Chicago: American Library Association, 1995.

Klepper, Robert, and Wendell O. Jones. *Outsourcing Information Technology, Systems, and Services.* Paramus, N.J.: Prentice Hall, 1997.

Kuong, J. F. ed. *Outsourcing Via Application Service Providers (ASP)—Guidelines, SLAs and Success Factors.* Translated by Management Advisory Services, Publications Consulting Group NA. Wellesley Hills, Mass.: Management Advisory Publications, 2000.

Lacity, Mary Cecelia, and Rudy Hirschheim. *Beyond the Information Systems Outsourcing Bandwagon: The Insourcing Response.* New York: John Wiley & Sons, Inc., 1995.

—*Information Systems Outsourcing: Myths, Metaphors and Realities.* Wiley Series in Information Systems. New York: John Wiley & Sons, Inc., 1993.

Law, I. *Harnessing Outsourcing for Business Advantage.* Financial Times Management Briefings. Paramus, N.J.: Financial Times/Prentice Hall, 1999.

Icon Group International, Inc. *Hamburger Getreide-Lagerhaus Ag: International Competitive Benchmarks and Financial Gap Analysis.* Financial Performance Series. San Diego, Calif.: Icon Group International, Inc., 2000.

—*Computer Outsourcing Services, Inc.: Labor Productivity Benchmarks and International Gap Analysis*. Labor Productivity Series. San Diego, Calif.: Icon Group International, Inc., 2000.

Marcella, A. *Outsourcing, Downsizing and Reengineering*. Altamonte Springs, Fla.: Institute of Internal Auditors, Inc., 1995.

Mylott, Thomas R., III. *Computer Outsourcing: Managing the Transfer of Information Systems*. Paramus, N.J.: Prentice Hall, 1995.

National Communications Forum. *Inside the Market for WAN Management Outsourcing*. 2000.

Nelson-Nesvig, Carleen. *Outsourcing Solutions: Workforce Strategies That Improve Profitability*. Traverse City, Mich.: Rhodes & Easton, 1997.

O'Looney, John A. *Outsourcing State and Local Government Services*. Westport, Conn.: Greenwood Publishing Group, Inc., 1998.

Phillips, Jack J., ed. *In Action: Building Learning Capability Through Outsourcing*. Alexandria, Va.: American Society for Training & Development, 2000.

Read, Brendan B. *Designing the Best Call for Your Business: A Complete Guide for Location, Services, Staffing and Outsourcing*. Lawrence, Kans.: CMP Books, 2001.

Ripin, Kathy M., and Leonard R. Sayles. *Insider Strategies for Outsourcing Information Systems: Building Productive Partnerships, Avoiding Seductive Traps*. New York: Oxford University Press, 1999.

Rittenberg, Larry E. *The Outsourcing Dilemma: What's Best for Internal Auditing*. Altamonte Springs, Fla.: Institute of Internal Auditors, Inc., 1997.

Robbert, Albert A., Susan M. Gates, and Marc N. Elliot. *Outsourcing of DOD Commercial Activities: Impacts on Civil Service Employees*. Santa Monica, Calif.: Rand Corporation, 1997.

Rothery, Brian, and Ian Robertson. *The Truth About Outsourcing*. Burlington, Vt.: Ashgate Publishing Company, 1995.

Sammons, Peter A. *The Outsourcing R & D Toolkit*. Burlington, Vt.: Ashgate Publishing Company, 2000.

Stationary Office Publications. *Outsourcing Best Practice Guidelines*. The Stationary Office, 1995.

Stees, John D. *Outsourcing Security: A Guide for Contracting Services*. Woburn, Mass.: Butterworth-Heinemann, 1998.

Surpin, Jo, and Gerri Weideman. *Outsourcing in Health Care: The Administrator's Guide*. Chicago: American Hospital Publishing, Inc., 1999.

Wilson, Karen A., and Marylou Colver, eds. *Outsourcing Library Technical Services Operations: Practices in Academic, Public, and Special Libraries*. Chicago: American Library Association, 1997.

Performance Measurement

Brimson, James A., and John Antos. *Driving Value Using Activity-Based Budgeting*. New York: John Wiley & Sons, Inc., 1999.

Coleman, Stephen H., and Thomas G. Wagner. *CPA Performance View Services: A Practitioner's Guide to Providing Performance Measurement Engagements.* New York: American Institute of CPAs, 2000.

Eggers, William. *Performance-Based Contracting: Designing State-of-the-Art Contract Administration and Monitoring Systems.* Los Angeles: Reason Public Policy Institute, 1997.

Governmental Accounting Standards Board. *Service Efforts and Accomplishments Reporting.* Concepts Statement No. 2. Norwalk, Conn.: Governmental Accounting Standards Board, 1994.

Leithe, Joni L. *Implementing Performance Measurement in Government: Illustrations and Resources.* Chicago: Government Finance Officers Association, 1997.

Maxwell School of Syracuse University. *The Government Performance Project Report.* Norwalk, Conn.: Governmental Accounting Standards Board, 1999–2001.

Tigue, Patricia, and Strachota, Dennis. *The Use of Performance Measures in City and County Budgets.* Chicago: Government Finance Officers Association, 1997.

Performance Soft™. *CPA Views.* 2000

Privatization

Donlevy, John W., Jr. *Inter-Governmental Contracting for Public Services.* Los Angeles: Reason Public Policy Institute, 1994.

Eggers, William D. *Competitive Neutrality: Ensuring a Level Playing Field in Managed Competitions.* Los Angeles: Reason Public Policy Institute, 1998.

—*Cutting Local Government Costs Through Competition and Privatization.* Los Angeles: Reason Public Policy Institute.

—*Designing a Comprehensive State-Level Privatization Program.* Los Angeles: Reason Public Policy Institute, 1993.

—*Privatization Opportunities for States.* Los Angeles: Reason Public Policy Institute, 1993.

—*Rightsizing Government: Lessons From America's Public-Sector Innovators.* Los Angeles: Reason Public Policy Institute, 1994.

Eggers, William D., ed. *Revitalizing Our Cities: Perspectives From America's New Breed of Mayors.* Los Angeles: Reason Public Policy Institute, 1995.

Gibbon, Henry. *Guide for Divesting Government-Owned Enterprises.* Los Angeles: Reason Public Policy Institute, 1996.

Gillette, Clayton P. *Public Authorities and Private Firms as Providers of Public Goods.* Los Angeles: Reason Public Policy Institute, 1994.

Hartman, Roger. *Contracting Water and Wastewater Utility Operations.* Los Angeles: Reason Public Policy Institute, 1993.

Hilke, John. *Cost Savings from Privatization: A Compilation of Study Findings.* Los Angeles: Reason Public Policy Institute, 1993.

Love, Jean, and Wendell Cox. *Competitive Contracting of Transit Services.* Los Angeles: Reason Public Policy Institute, 1993.

Martin, Lawrence. *How to Compare Costs Between In-House and Contracted Services.* Los Angeles: Reason Public Policy Institute, 1993.

Moore, Adrian T. *Integrating Municipal Utilities into a Competitive Electricity Market.* Los Angeles: Reason Public Policy Institute, 2000.

—*Private Prisons: Quality Correction at Lower Cost.* Los Angeles: Reason Public Policy Institute, 1998.

Moore, Adrian T., Geoffrey F. Segal, and John McCormally. *Infrastructure Outsourcing: Leveraging Concrete, Steel, and Asphalt with Public-Private Partnerships.* Los Angeles: Reason Public Policy Institute, 2000.

O'Leary, John, and William D. Eggers. *Privatization and Public Employees: Guidelines for Fair Treatment.* Los Angeles: Reason Public Policy Institute, 1993.

Poole, Robert W., Jr. *Guidelines for Airport Privatization.* Los Angeles: Reason Public Policy Institute.

—*Objections to Privatization.* Los Angeles: Reason Public Policy Institute.

—*Privatizing Emergency Medical Services: How Cities Can Cut Costs and Save.* Los Angeles: Reason Public Policy Institute, 1995.

Poole, Robert W., Jr., and Lynn Scarlett. *Cutting State Deficits: Role of Privatization.* Los Angeles: Reason Public Policy Institute, 1991.

Rehfuss, John. *Designing an Effective Bidding and Monitoring System to Minimize Problems in Competitive Contracting.* Los Angeles: Reason Public Policy Institute, 1993.

Scarlett, Lynn, and J. M. Sloan. *Solid Waste Management: A Guide for Competitive Contracting for Collection.* Los Angeles: Reason Public Policy Institute, 1996.

Segal, Geoffrey, and Adrian T. Moore. *Privatizing Landfills: Market Solutions for Solid-Waste Disposal.* Los Angeles: Reason Public Policy Institute, 2000.

Snell, Lisa. *Child-Welfare Reform and the Role of Privatization.* Los Angeles: Reason Public Policy Institute, 2000.

—*Getting Greens in the Black: Golf Course Privatization Trends and Practices.* Los Angeles: Reason Public Policy Institute, 1999.

Stainback, John. *Designing Comprehensive Privatization Programs for Cities.* Los Angeles: Reason Public Policy Institute, 1993.

U.S. Government Accounting Office. *Report to the Chairman, House Republican Task Force on Privatization—Privatization: Lessons Learned by State and Local Governments.* Report No. GGD-97-48. Washington, D.C.: Government Accounting Office, March 1997.

STUDIES AND REPORTS

This listing contains studies and reports related to privatization or performance measurement, some available for free, some accessible via the Internet.

GASB. *State and Local Government Case Studies: The Use and the Effects of Using Performance Measures for Budgeting, Management, and Reporting.* 2000. The fourth *Managing for Results* conference in Austin, Texas, was the occasion for releasing the GASB's first twelve case studies of the development and use of performance measures in state and local governments. (www.rutgers.edu/Accounting/raw/seagov/pmg)

International City/County Management Association. *Alternative Service Delivery Methods and the Competition Process.* 1997. This report discusses alternative service delivery methods and the trends and practices associated with their use. (www.icma.org)

International City/County Management Association. *Bidding on Service Delivery: Public-Private Competition.* 1993. This report covers the types of services put up for bid and the strategies used to implement public-private competition. (www.icma.org)

International City/County Management Association. *Employee Issues in Privatization.* 1995. How to anticipate and minimize the negative impact of privatization on employees. (www.icma.org)

International City/County Management Association. *Guidelines for Asset Management.* 1998. Guidelines developed to pursue privatization as a way to improve asset management in North Carolina. (www.icma.org)

International City/County Management Association. *Selecting Services for Public-Private Competition.* 1996. Report summarizes criteria to determine which services are most appropriate for public-private competition. (www.icma.org)

International City/County Management Association. "A Blueprint for Privatization and Competition," by John McGillicuddy. November 1996. Article in the ICMA magazine *Public Management* discusses guidelines for considering privatization and other forms of competition for cities and towns. (www.icma.org)

Maxwell School of Syracuse University. *The Government Performance Project.* 2001. This is a report on the second comprehensive survey of state government management. All fifty states are graded on how well they manage the systems that deliver public services. The project aims to improve the understanding of government management on the city, county, state, and federal levels, first by facilitating a better intellectual understanding of the dimensions of management in government, and second by holding government entities publicly accountable for the quality of management in their jurisdictions. The GPP shines a spotlight on public management, which, in the "old view" of management and performance, is equivalent to the "black box" of government. (www.rutgers.edu/Accounting/raw/seagov/pmg)

Reason Public Policy Institute. *Privatization 2000.* Fourteenth Annual Privatization Report. 2000. This annual report tracks the latest trends in privatization. (www.rppi.org)

Reason Public Policy Institute. *Directory of Private Service Providers.* 1996. A contact and address listing of over 200 private companies that manage and/or operate public services. Includes investment bankers, facilities management firms, public-safety service providers, solid waste disposal firms, and many others. (www.rppi.org)

Reason Public Policy Institute. *Privatization Watch.* Up-to-date information on public-private partnerships. (www.rppi.org)

Public-Private Partnerships 1997: Issues and Resources for State and Local Governments. Chicago: Government Finance Officers Association, 1997. This research rêport examines why, how and under what circumstances the public and private sectors can effectively collaborate for delivering government services or for financing public facilities. Includes an overview of the issues (such as selecting services for contracting/outsourcing, managed competition, cost and related factors, and legal/regulatory concerns), methods for evaluating potential partnerships, an extensive bibliography and a list of resources and contacts. Weiss, Barbara, and Tigue, Patricia. *Public-Private Partnerships 1997: Issues and Resources for State and Local Governments.*

Service Efforts and Accomplishments Reporting: Its Time Has Come. Norwalk, Conn.: Governmental Accounting Standards Board, 1990. This research report by the Governmental Accounting Standards Board provides an overview of the accounting for service efforts and accomplishments of state and local governments. It addresses accountability for results and outcomes of government services and provides example performance measures in a number of typical government services.

The Use of Performance Measures in City and County Budgets. Government Finance Officers Association, 1994. This research report examines the use of performance measures in a sample drawn from operating budget documents submitted by state and local governments to the GFOA's Distinguished Budget Presentation Awards Program. It also includes a list of quality and efficiency measures reported by city and county governments in the study.

Web Sites

This section lists some of the many worldwide Web sites designed for improving performance in government and not-for-profit organizations. More than the entries in any other section, the Web sites are subject to change. New Web sites come online every day. This listing simply attempts to show the wide range of information available from the Internet and to get you started.

Competition, Outsourcing, and Privatization

Advancing Government Accountability
www.agacgfm.org

Arthur Andersen
www.arthurandersen.com (See Media Offerings—Outsourcing)

Governing Magazine Online
www.governing.com

GovExec
www.govexec.com/outsourcing

Outsourcing Government
www.outsourcing-government.com

The Outsourcing Institute
www.outsourcing.com

Mackinac Center for Public Policy
www.mackinac.org

National Center for Public Policy Analysis
www.ncpa.org/pd/private/priv5.html

Reason Public Policy Institute—Privatization
www.privatization.org

Performance Management and Measurement

Alan K. Campbell Public Affairs Institute
Government Performance Project
www.maxwell.syr.edu/gpp

Alfred P. Sloan Foundation
www.sloan.org/programs/stndrd_performance.htm

Alliance for Redesigning Government
www.alliance.napawash.org/alliance/index.html

American Evaluation Association
www.eval.org

Association of Government Accountants
www.agacgfm.org

Brookings Center for Public Management
brookings.org/gs/cps/cpmpubs.htm

Center on Municipal Government Performance
www.fcny.org/html/center.htm

Citizens League
www.citizensleague.net

Congressional Institute
www.conginst.org/conginst.nsf?OpenDatabase

Council for Excellence in Government
www.excelgov.org

Florida Government Accountability Report
www.oppaga.state.fl.us/government

Foundation for Performance Measurement
www.fpm.com

Governmental Accounting Standards Board (GASB)
www.gasb.org

ICMA's Center for Performance Measurement
www.icma.org/abouticma/programs/performance

The Innovation Groups
www.ig.org

Institute of Internal Auditors
www.theiia.org

Institute of Management Accountants
www.imanet.org

Minnesota Office of the Legislative Auditor
www.auditor.leg.state.mn.us/ped/pedintro.htm

NACUBO's Effective Practices Database
www.nacubo.org

National Association of State Auditors, Comptrollers and Treasurers
www.sso.org

National Center for Public Productivity
www.andromeda.rutgers.edu/~ncpp/

National Performance Review
Vice President Al Gore's "National Partnership for Reinventing Government" (NPR) officially closed on January 19, 2001. The organization's Web site (www.npr.gov) is archived at http://govinfo.library.unt.edu/npr/default.htm

OECD's Public Management Service
www.oecd.org/puma/

Performance Measurement for Government Web Site
www.rutgers.edu/Accounting/raw/seagov/pmg

Texas Performance Review
http:www.window.state.tx.us/tpr/tpr4/tpr4.html

Chapter 8:

PowerPoint Presentation for Clients and Management

Presentation and Speaker's Notes

The PowerPoint presentation included with this practitioner's guide, titled *Using Competition for Performance Improvement,* is to be used to present and explain using competition for performance improvement to potential clients and management. Presented on the following pages are copies of those presentation slides and speaker's explanation notes.

Personalizing Your Presentation

Follow these steps to personalize the *Using Competition for Performance Improvement* presentation disk with your firm name:

1. Click on Microsoft PowerPoint.
2. Click on Existing Presentation.
3. Click OK.
4. In dialog box, select 3½ Floppy (A:).
5. Click on usingcompetition.
6. Click OPEN.
7. On the first slide, move the cursor to "Firm Name" and double click.
8. Delete the row of letters and type in your name and your firm name.
9. Click outside the box when finished.
10. Advance to the last slide.
11. Complete the same steps to enter your name, address, and phone number.
12. When complete, click on FILE.
13. Click on SAVE AS.
14. Select 3½ Floppy (A:).
15. Click on SAVE.
16. Remove disk.

Slide 1

This slide is the introductory slide and will be tailored by the CPA firm with its name.

> ## Using Competition for Performance Improvement
>
> **Guidelines in the Development and Management of the Competition Process**
>
> *[Firm Name]*

Slide 2

Competition in relation to government or not-for-profit organizations and the for-profit businesses (referred to as "private sector") can be categorized in three general ways:

1. *Government or not-for-profit organizations versus private sector*—in which government and not-for-profit organizations compete with the private sector to perform functions or activities previously performed by the government or not-for-profit organizations.
2. *Government or not-for-profit organizations versus other government or not-for-profit organizations*—in which governments and not-for-profit organizations compete among themselves to perform their functions or activities.
3. *Private sector versus private sector*—in which private-sector organizations compete among themselves to perform government and not-for-profit organization functions or activities.

> ## What Is Meant by Introducing Competition?
>
> - Two or more parties independently attempt to secure the business of an entity by offering the most favorable terms
>
>   This includes --
>   - Government or not-for-profit organizations versus the private sector
>   - Government or not-for-profit organizations versus other government or not-for-profit organizations
>   - Private sector versus private sector

Slide 3

Point out that the end result of introducing competition is not always privatization. The performance of the service by an outside provider may not always be the "best fit" for a function or activity in which competition may be introduced. For many reasons, government and not-for-profit organizations must continue to provide some services. In some instances, legal or regulatory requirements may require the service to be performed in-house. In others, competition may not be viable for other reasons.

The process of introducing competition can still result in improvement to the quality of service or reduction in costs from the entity retaining or modifying the service delivery.

There are generally three alternative actions from introducing competition.

Privatization—Shifting service delivery to an outside provider or contractor

- **Outsourcing**—A privatization action resulting in using an outside provider for some or all of a target function or activity's service delivery. Point out that the tasks are outsourced, but the responsibility is not.
- **Divestiture**—A privatization action where the entity sheds part of the target function or activity's service or stops providing the service altogether. If sufficient demand, the private sector may pick up.

Retention—Occurs when the target function or activity goes unchanged and is provided in-house by the entity. Competition can still serve as a motive to manage employees.

Reengineering—Occurs when the target function or activity stays with the entity but with the introduction of competition, changes have been identified to function more efficiently or effectively.

What Can Result From Introducing Competition?

- **Privatization** - The shift of a target function or activity's service delivery to an outside contractor or provider
  - **Outsourcing** -- Entity remains responsible for the service.
  - **Divestiture** -- Entity is no longer responsible for the service.
- **Retention** - Entity keeps the target function or activity with little or no change in the delivery approach.
- **Reengineering** - Entity keeps the target function or activity but changes the delivery approach.

Slide 4

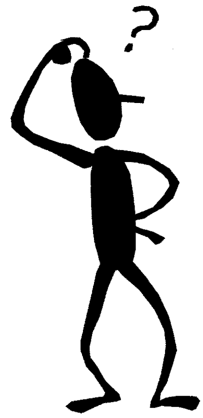
This slide itemizes reasons to consider competition in government and not-for-profit organizations.

Point out that competition is a management tool that enables governments and not-for-profit organizations to better meet the needs of their constituents, customers, or clients by lowering costs, improving service, and ultimately refocusing these entities on the core services that they should or must provide. Implementing a competitive environment in a fair and consistent manner will lead to—

- **Cost savings**—Competition in the marketplace results in continuous focus on cost savings.
- **Improved service quality**—Well-designed contracts, specific performance standards, and comprehensive monitoring will result in increased quality of service.
- **Increased efficiency**—Competition drives parties to become innovative to continue to deliver services in new and improved ways.
- **Increased flexibility**—The consideration of alternative methods of service delivery provides officials with greater flexibility in their efforts to meet users' needs.

Why Introduce Competition?

- Cost savings
- Improved service quality
- Increased efficiency
- Increased flexibility



Slide 5

How do you know if a change in the method of service delivery is needed?

There could be financial warning signals, such as a trend of deteriorating equity or net assets, or costs incurred in excess of revenues.

With the continued revenue raising caps placed on governments by taxpayers and increased competition among not-for-profit organizations for donations and grants, there is an increasing need to consider competition as a viable alternative.

Performance measures could show poor results or service delivery, or that anticipated results are not being achieved.

Previous successful experiences resulting from the introduction of competition can be strong factors in further efforts to compete. *Success breeds more attempts at success.*

Indications That Competition May Be Needed

- Financial statement warning signs
- Internal and external pressures
- Performance measurement indications
- Previous successful competition efforts

Slide 6

Consideration should be given to the possibility that certain impediments to competition may exist due to the nature of the entity. Laws and regulations could impair the ability to introduce competition. Labor contracts may have employment provisions that hinder competition. Grant agreements may stipulate the manner of the competitive bids. In addition, campaign or fund-raising promises, lobbying efforts, and other political forces may have a significant impact on the process of introducing competition. In some cases, legislative or policy changes may be required to encourage and facilitate the introduction of competition.

Constraints in Introducing Competition

- Provisions of laws and regulations
- Grant award contractual requirements
- Provisions in labor contracts
- Campaign or fund-raising issues

Slide 7

A 1997 U.S. General Accounting Office (GAO) study on privatization addressed lessons learned in privatizing activities in six large state and local governments. This slide shows the six primary lessons learned.

A copy of the GAO study can be obtained from their office at—

U.S. Government Accounting Office
P.O. Box 6015
Gaithersburg, MD 20884-6015
Web site: www.gao.org
Phone: (202) 512-6000
Fax: (301) 258-4066

Lessons Learned in Introducing Competition

- Best introduced/sustained when organizational leadership champions
- Leadership establishes an organizational and analytical structure to ensure effective implementation
- May need legislative changes to privatize
- Need reliable cost data to support decisions and performance
- Need strategies to manage workforce
- Need sophisticated monitoring/oversight

Slide 8

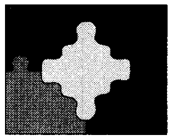
The point should be made that in identifying potential target functions or activities for introduction of competition, evaluation should be made of the likelihood of achieving goals through a successful project.

Factors likely to contribute to a successful project follow.

- Sufficient suppliers should exist.
- Quality of service should meet or exceed current level.
- Appropriate level of monitoring or oversight over performance must be achieved.
- Risk of unfavorable exposure should be low.
- Competition should not be hindered by laws or negatively affected by political forces.
- To the extent possible, the net impact on affected employees should be positive and compatible with collective bargaining.
- The potential outside providers should possess or have access to adequate personnel, capital, and other resources to provide the service effectively.

Factors for Considering Introduction of Competition

- Strong marketplace
- Potential for improved quality
- Assurance of continued control



- Low risk of unfavorable exposure
- Limited legal and/or political barriers
- Minimal adverse employee impact
- Available resources

Slide 9

This slide should be tailored to meet the needs of the entity to which the speaker is speaking. (See chapter 2 for examples; see also table 2.1.)

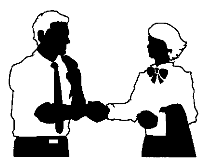
What Activities Would You Consider for Introducing Competition?

Slide 10

This is an introductory slide to address the purpose of establishing a competition task team to coordinate the competition project.

1st Step - Select the Competition Task Team

Purpose of the team is to coordinate continued tasks of the competition introduction process.



Slide 11

This slide indicates the importance of having a strong team. Consideration should be given to including representatives from—

- Budget and finance
- Procurement
- Human resources
- The specific target function or activity
- Customers, constituents, and clients
- Employees or employee union

The importance of these people will be noted by the expectations of the competition task team, as noted in the following slide.

Who Should Be on the Competition Task Team?

Persons with:

- Wide range of disciplines/experience
- Practical experience in the target function or activity's service delivery
- Financial/accounting experience essential (for some members)

Slide 12

The competition task team will determine whether to move forward at each succeeding step henceforth. This group will coordinate the effort and recommend the decision as a result of introducing competition into the target function or activity.

Both a team leader and a transition leader should also be named.

The team leader will be responsible for coordinating the team's activities and meetings throughout the entire project. This leader should ideally be the individual that is the most independent in terms of the effect of introducing competition into the target function. An independent CPA would be a good candidate for this function.

The transition leader will be responsible for implementing and managing the contract if someone other than the current government and not-for-profit organization is selected to provide the service or the service is sold as a result of the competition process. Appointing this individual early in the life of the team will enable him or her to become familiar with the project and its goals and participate in defining the transition and monitoring process.

Competition Task Team Will --

- Review qualitative analysis of target function.
- Select the most appropriate competition strategy.
- Coordinate the competition proposal process.
- Review monitoring, logistics, and personnel plans.
- Review cost analysis and comparisons.
- Make the provider selection recommendation.
- Oversee the monitoring process.

Slide 13

This slide allows the CPA to explain briefly how the Competition Profile Form (see exhibit 2.1 in chapter 2) can be used to conduct the qualitative analysis to determine whether the target function or activity should be pursued further for introduction of competition.

2nd Step - Perform Qualitative Analysis

Go through a series of questions related to each of these factors as noted earlier.

- Strength of marketplace
- Quality of service
- Control
- Risk
- Legal barriers
- Political resistance
- Impact on employees
- Resources

Slide 14

Point out that the completion of the qualitative analysis is the first formal decision point in the competition introduction process.

Explain that to continue with the competition project, the qualitative analysis should indicate a potential for success in introducing competition into the target function or activity.

2nd Step - Perform Qualitative Analysis (cont.)

- Consider weighted positive/negative aspects in promoting successful competition.
- Review results and mitigating factors in completing the profile summary.

[If the summary appears to warrant further consideration of introducing competition, go to next step.]

Slide 15

Describe the alternative competition strategies or approaches available for consideration. Consider including a practical example of each strategy (see the examples in chapter 3).

What Is the Most Appropriate Competition Strategy?

- Contracting out
- Managed competition
- Vouchers
- Partnerships
- Franchising
- Volunteerism
- Service shedding
- Asset sale or lease

- **Contracting out**—Contracting out is a form of outsourcing that involves the hiring of another party to provide goods or services for the contracting entity.
- **Managed competition**—The concept of managed competition is a relatively newer competition strategy. Under a managed competition approach, a government or not-for-profit organization competes with private-sector firms or other government and not-for-profit organizations to provide services under a controlled or managed process.
- **Vouchers**—Vouchers are a form of outsourcing that involves financial subsidies given to individuals for purchasing goods or services from the available providers. A government or not-for-profit organization gives individuals certificates or vouchers to purchase the goods or services in open market.
- **Partnerships**—Sometimes referred to as a joint-venture, a partnership is an outsourcing approach that involves a contractual agreement formed between governments, not-for-profit organizations, or private sector partners, or a combination of them.
- **Franchising**—Franchising is a form of outsourcing that involves a government or not-for-profit organization granting an exclusive right to a private business to provide a government or not-for-profit organization service in a certain geographical area.
- **Volunteerism**—Volunteerism is another form of outsourcing that involves volunteers performing all or a part of a government or not-for-profit organization's function or activity.
- **Service shedding**—Shedding is a form of divestiture in which the government or not-for-profit organization reduces the level of service provided or stops providing a service altogether. Private-sector businesses or other governments or not-for-profit organizations may step in to provide the service if there is a market demand.
- **Asset sale or lease**—Another divestiture approach is an asset sale or lease arrangement. An asset sale or lease involves the ultimate transfer of ownership of government or not-for-profit organization assets or functions to the private sector.

Slide 16

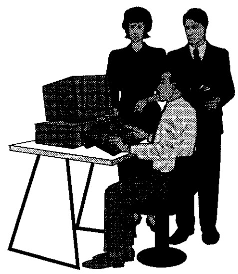
The team is now in place and a competition strategy has been selected. The team must now begin planning the introduction of competition. Early planning allows the team to address such considerations as the specific scope of the project, performance monitoring, the transfer of service delivery, and effect on personnel. These issues should be considered early in the process in order for a complete and comprehensive request for proposal (RFP) to be prepared.

In addition, the concerns of elected officials or board members, employees, and service recipients are addressed and efforts are made to garner their support for the competition efforts.

3rd Step - Planning to Introduce Competition

Competition task team to address:

- Specific scope of project
- Performance monitoring
- Effect on personnel
- Transfer of service delivery
- Stakeholder concerns



Slide 17

Define and consider providing examples of the issues that should be addressed in determining the specific scope of the project.

Explain that the scope of the project was initially defined when the target function or activity was considered using the qualitative analysis (see chapter 2). The results of addressing these specific scope issues may provide additional information resulting in the need to consider changes to the project's initial scope.

The remaining activities involved in planning for competition cannot proceed without a clearly defined project scope. After the specific scope is defined, initial planning should be conducted in the areas of performance monitoring, service transition, and dealing with affected personnel.

Determining Specific Project Scope

- Understand the target function or activity
- Define competition objective
- Determine contract period
- Describe service tasks or deliverable products
- Specify acceptance standards
- Obtain input from outside providers
- Finalize project scope

Slide 18

The development of written performance measures agreed upon by the interested provider is essential to effective performance. Unless the target function or activity is eliminated, the contracting entity cannot be relieved of its responsibility for customer satisfaction.

Performance measures could be—

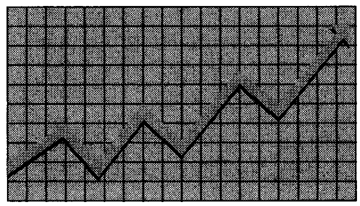
- Inputs—resources used.
- Outputs—units produced or serviced.
- Outcomes—goal achievements (effectiveness).
- Efficiencies—costs or inputs per unit of output.
- Cost-effectiveness—costs or inputs per unit compared to outcomes.

Consider providing performance indicator examples (see table 3.1 in chapter 3).

Performance Monitoring

Performance measures can include the following:

- Inputs
- Outputs
- Outcomes
- Efficiencies
- Cost-effectiveness



Slide 19

Performance monitoring requires the entity to interact with the provider and customer and enables timely corrective action, if necessary.

A good plan requires reporting on predefined measurement criteria.

The organization must review and follow up on the provider's reports.

Financial and compliance monitoring will help determine whether the costs of the contract are within the contract parameters and in compliance with applicable laws and regulations.

Inspections should be made to ensure results comply with contract requirements.

Delivery satisfaction should be ensured with customer surveys, complaint monitoring, or both.

Performance Monitoring (cont.)

- Periodic provider reporting
- Financial and compliance audits
- On-site inspections
- Service recipient surveys
- Complaint monitoring

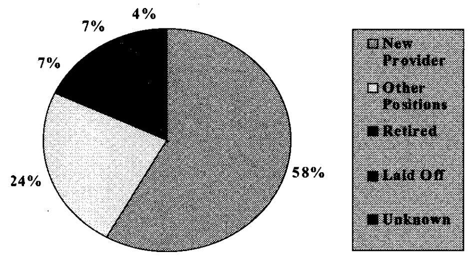
Slide 20

This slide indicates that should privatization be selected, involuntary separation of employees has not typically been the end result.

Based on the U.S. Department of Labor study of 34 privatization programs, most employees retained their jobs. Loss of employment is a major concern and should be addressed in the planning stage and addressed in the RFP.

Develop Personnel Plan

US Dept. of Labor study of 34 privatization efforts shows the impact on employees:



Slide 21

The objective of a personnel plan is to make the change the least disruptive for employees. Early planning should minimize involuntary separation. Consideration should be given to various options.

If possible, the contract should contain a right of first refusal that requires the new provider to offer employment to displaced employees before going into the open marketplace.

Where possible, transfers within the entity should be afforded.

Entities can implement early retirement programs.

As a last resort, the organization can look at a reduction in the workforce and terminate employees upon elimination of their position.

Develop Personnel Plan (cont.)

Personnel options:

- Right of first refusal
- Transfer with the entity
- Early retirement
- Reduction in force

Slide 22

The goal in any transition plan is to make the change transparent to the service recipient.

Develop Service Transition Plan

The service transition plan addresses how service delivery would actually change to another organization if an outside provider is selected.

Slide 23

It is important to note here that identification of each of these items is very important not only for a clear understanding with the provider but also to develop accurate cost comparisons as the competition process continues.

Develop Service Transition Plan (cont.)

Logistics to be considered:

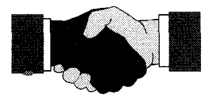
- What capital assets will be affected?
- What changes there will be in personnel, materials, and other costs?
- What changes will occur in contractual or lease obligations?
- How and when will customers be notified?
- How will service delivery change?

Slide 24

An important part of the planning process is to garner the support of the stakeholders. Stress the importance of minimizing any threat to stakeholders and keeping them informed.

Address Stakeholder Concerns

- Dealing with elected officials and board members
- Dealing with employees
- Dealing with customers, constituents, taxpayers, clients, and donors



Slide 25

Each of these concerns should be addressed to the level of satisfaction needed to continue with the competition project.

If all are satisfied, the RFP should be prepared and released and the competition task team should proceed with the cost analysis.

4th Step - Reevaluate Continuation of the Introduction of Competition

Questions to ask:

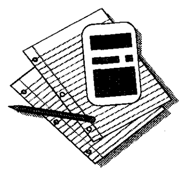
- Does the qualitative analysis support a decision to introduce competition?
- Has the specific project scope been defined and are deliverables capable of being provided by outside providers?
- Does the service delivery strategy meet the present/future needs?
- Does the performance monitoring plan indicate that effective measurement and monitoring is capable?
- Does the transfer logistics plan reflect a smooth transition?
- Does the personnel plan minimize disruption?
- Have stakeholder concerns been addressed and can support be obtained?

Slide 26

There will be varying degrees of difficulty in obtaining data, depending on accounting systems in place and whether information is readily available. The organization will need to identify and accumulate direct and indirect in-house costs as well as outside costs associated with transferring the target function or activity to a new provider to make the cost comparison.

5th Step - Perform the Cost Analysis

We are now at a necessary part of the decision-making process: determining whether cost savings results from transferring all or part of the target function or activity to a new provider.



Slide 27

The relevant in-house costs must be accumulated to facilitate comparison between the organization and the proposed contractor or provider.

Based on the responses to and the evaluation of the RFP, providers are recommended for further evaluation.

Outside contractor costs, along with the costs of managing and monitoring the outside contractor, must be accumulated.

At this point, the cost of retaining the target function or activity in-house is compared to the cost of transferring it to an outside provider.

Perform the Cost Analysis (cont.)

Steps include:

- Identifying relevant in-house costs
- Preparing and releasing the request for proposals and evaluating results
- Identifying and accumulating outside costs
- Comparing relevant in-house costs to outside costs

Slide 28

Consider defining and providing examples of the cost categories (see table 4.1 in chapter 4).

Point out the cost considerations used in comparing relevant in-house costs to outside costs. Schedule A, the Summary of Relevant Costs (see illustration 4.15 in chapter 4), can be used as an example to point out these considerations.

Considerations in Gathering Data for Cost Analysis

- Relevant (avoidable) in-house costs
- Unavoidable in-house costs
- Increases/decreases in revenue
- Outside contractor costs
- Contractor support and monitoring costs
- One-time conversion costs

Slide 29

Emphasize that this is the step where the final analysis is made.

Consideration should be to retain in-house or to award contract to an outside provider. Based on this analysis, proceed with the next step, making the recommendation.

6th Step - Select Provider

Consider:

- Provider agrees with final scope of service.
- Provider agrees with performance monitoring plan.
- Provider can meet the transfer logistics plan.
- Provider can meet the requirements of the personnel plan.
- Cost analysis indicates provider can provide service cost-effectively.
- Overall advantages exceed disadvantages.

Slide 30

The recommendation will come from the competition task team and be delivered to an evaluation committee. The evaluation committee will comprise key management officials responsible for acting on the recommendation of the competition task team.

A well-written contract should follow all of the issues addressed during planning and consideration. Responsibilities, performance measures, transfer logistics, and personnel plans should be specific. The contract should also address a contingency plan in the event of nonperformance.

Implementation of the performance monitoring, transition, and personnel plans should follow.

7th Step - Make Recommendation and Implement

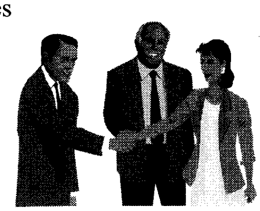
- Competition task team --
  - Recommends to an evaluation committee
    - In-house, as is, or with modifications.
    - Outside contractor or provider.
  - Develops a contract with selected provider, if appropriate.
  - Addresses implementation of monitoring, transition, and personnel plans.

Slide 31

Now that the CPA has defined what the competition process is, here are the strengths that the CPA or the CPA firm possesses to provide assistance to the organization.

What Are the CPA or CPA Firm's Strengths in the Introduction of Competition?

- Financial background
- Technical knowledge
- Business consulting competencies
- Experience with:
  - Project management
  - Accounting/information systems
  - Process design
  - Cost accounting analysis
  - Audit/monitoring function



Slide 32

These are examples of what the CPA or CPA firm can do to assist the organization.

This slide should be tailored to the presentation.

(See more specific examples of these services in chapter 1.)

What Role Can the CPA or CPA Firm Have?

- Competition process design
- Identification of potential target functions and activities
- Qualitative analysis
- Project management
- Cost analysis and comparison
- Performance monitoring
- Outsourcing opportunities

Slide 33

This is simply the final slide after explaining the competition process and indicating what services can be performed.

The slide can indicate who to contact in the firm or entity offering CPA services, and how.

Using Competition for Performance Improvement

Guidelines in the Development and Management of the Competition Process

[Firm Name]

Appendix A
Frequently Asked Questions

These questions and answers have not been acted upon by senior technical committees of the AICPA and do not represent an official position of the Institute.

General

What does the phrase "introducing competition into government and not-for-profit organizations" mean?

Introducing competition (as discussed in this publication) is the evaluation of an organization's functions and processes to determine whether there are margins of efficiency, cost-effectiveness, or strategic focus gained by contracting with a third party to perform all or part of these activities. The end result of introducing competition is not always privatization. Alternative actions resulting from introducing competition can generally be classified into three categories: privatization, in which the organization shifts service delivery in some form to an outside provider; retention, in which the organization retains the service delivery in-house with little or no change; and reengineering, in which the organization retains the service delivery in-house but modifies the service delivery.

Is this publication meant for CPA firms, or can CPAs work directly for government and not-for-profit organizations, assisting those entities when introducing competition?

This publication may be used by a wide range of practitioners. Those CPAs who work in government and not-for-profit organizations may use it as a tool for developing and assessing competition processes and the needs of their specific organizations. CPAs in public practice can use it to introduce their clients to competition-related issues and opportunities. Both CPAs in government and not-for-profit organizations and CPAs in public practice will find this publication useful in assisting their employers or clients in conducting and managing the competition project.

Why would a potential client or a government or not-for-profit employer use a CPA to perform services related to introducing competition?

The CPA's skills and competencies are specifically suited to assist in the competition process, since the CPA's training and background include project management skills, system or process design experience, cost accounting competencies, and financial and compliance audit experience.

How do I identify the opportunities for introducing competition into government and not-for-profit organizations?

After gaining an understanding of an organization's functions and processes and the relative strategic importance of these activities, the CPA should consider the following factors:

- Strength of the market of potential vendors
- Potential for improved quality
- Assurance of continued control
- Risk of unfavorable exposure
- Legal barriers
- Political resistance
- Employee impact
- Resources available to potential vendors

If these factors indicate a high potential for success, the CPA should perform further qualitative assessment for the potential transfer of service delivery to an outside contractor or provider.

What is the difference between privatization and outsourcing?

For the purposes of this publication, privatization includes any process aimed at shifting activities, functions, and in some cases, responsibilities from a government or not-for-profit organization to another government or not-for-profit organization or to the private sector. Privatization is further classified in two ways, as: (1) outsourcing, in which the organization retains responsibility for the target function or activity's service; and (2) divestiture, in which the organization no longer retains service responsibility.

If a decision is made to consider privatization of a government or not-for-profit organization's function or activity, what different approaches or competition strategies should be considered?

Privatization generally results in one of two forms of action being considered: outsourcing or divestiture. The various approaches to outsourcing include contracting out, managed competition, vouchers, franchising, partnerships, and volunteerism. Generally, the two approaches to divestiture are service shedding, and asset sale or lease.

When deciding which competition strategy is the best approach or method, the following questions should be addressed.

- Who is the customer and how many customers need service?
- What is the nature of the service?
- How many qualified providers are available to provide the service?
- How important is direct control over the service delivery?

What procedures do I need to perform to plan for competition?

Successfully introducing competition requires early planning and preparation to address such considerations as the specific scope of the project, performance monitoring, the transfer of service delivery (if applicable), and any concerns that stakeholder groups may have, such as elected officials or board members, employees, and service recipients. In planning for the introduction of competition, the primary objective is to ensure that proper consideration is given to factors that will affect the implementation of the remainder of the project. In this phase of the project, an evaluation and definition of how the target function or activity is currently providing the service, and a definition of what will be done to provide the service in the future, are agreed upon. This planning and preparation are essential to realize the ultimate goals of improving performance and cost-effectiveness.

How important is performance measurement and monitoring to the process of introducing competition?

Performance monitoring is critical to ensure the continued quality of the service provider's performance. It ensures that the provider fulfills the agreed terms of engagement and that affected customers and constituencies are satisfied with rendered services. Performance measurement indicators and standards should be included in both the request for proposal and any contract with the service provider.

What is activity-based costing and how is it used when introducing competition?

Activity-based costing (ABC) is a method of cost accounting that provides for the identification of the elements of cost incurred to accomplish a purpose or function, carry out an activity, or complete a specific job or task by the nature of the underlying activity, as opposed to more traditional expense categories. ABC is an important way of evaluating results both before and after the introduction of competition. If ABC is not used, other methods of gathering target function or activity costs are acceptable. Cost information can be gathered from either ongoing cost accounting systems or periodic cost studies of specific target functions or activities.

COMPETENCIES

Do I need to have any specific prior experience to assist an entity in introducing competition?

No. Having an understanding of the competition issues and concepts and being able to identify the appropriate issues applicable to the target function or activity are the key considerations. However, there is a need for the practitioner to have or obtain a thorough understanding of the government or not-for-profit organization's functions and activities. In addition, certain skills are needed to provide assistance in this area. (See the following question, which deals with necessary skills.)

What general or specific skills are needed to assist in these services?

The basic skills needed are those general attributes of judgment, business sense, and a strong understanding of the industry and its related functions and processes. Some other specific skills that benefit the delivery of these services include the following:

- Strong analytical abilities
- Financial modeling acumen
- Interviewing skills
- Meeting facilitation and management skills
- Human resource management skills
- Process mapping abilities

Engagement Issues

What role or roles can the CPA play in the competition process?

There are various roles for the CPA. The most common and most significant roles involve project management, oversight, and facilitation, particularly *after* an organization has decided to outsource a function. During these transition periods, the organization's management and staff must remain focused on their existing job responsibilities. It is very difficult to maintain quality performance during these periods. Therefore, management may not have the capacity to properly oversee the transition process. CPAs often fill this temporary, but very critical, need. Other roles as financial advisers and analysts relate to the competition design process, the identification of target functions, and the qualitative analyses involved in making and implementing these decisions. Finally, CPAs also have the opportunity to serve as the provider for the outsourced function, particularly functions such as accounting and financial reporting or internal audit.

Will this type of engagement result in the issuance of a report by the CPA?

Typically, no. Although there are several "reports," presentations, and analyses that may be prepared by the CPA, there is rarely an issuance of an independent auditor's report or other attestation report relating to these services. A CPA may be requested to issue an agreed-upon procedures letter, but that is also likely to be a rare request.

Marketing

What organizations make up the market for these services?

Any organization is a potential target for these services. However, government or not-for-profit organizations with new management or ones facing increasing financial constraints are most likely to engage in these considerations.

How do I get the attention of potential clients or of my employer in considering the use of competition?

Potential clients will be most interested in potential savings, operational efficiencies, and improved service delivery and flexibility that the use of competition provides. An improved organizational focus may result in an intangible benefit best demonstrated by testimonial evidence from executives who have used competition in their organizations. Documented savings and operational efficiencies (such as the examples cited in chapter 1) are strong wake-up calls to the potential competition. A CPA may also be able to estimate cost savings and improved operational efficiencies. These estimates may convince a potential client to further consider the use of competition.

Appendix B

Glossary

Activity-based costing. A method of cost accounting that accumulates the full costs, both direct and in-direct costs, of a specific function or activity.

Asset sale or lease. A competition strategy and form of divestiture that involves the sale, lease, or other disposition of capital assets owned by the government or not-for-profit organization to the private sector or other outside provider as part of the competition process.

Competition. Applying the concepts of free markets to enhance the cost and operational effectiveness of service delivery. In the context of this publication, competition is between government, not-for-profit, and private sector entities.

Competition task team. Representatives with a wide range of discipline and experience responsible for coordinating the tasks of the competition process and making a provider recommendation to the evaluation committee.

Contract period. A period of time (for example, three years) established in the request for proposal (RFP) that the service contract with an outside provider covers. This period is used in conducting the cost comparison of in-house and outside costs. Annual renewal of contracts may be legally required in certain governments, regardless of the contract period.

Contracting out. A competition strategy and form of outsourcing that involves a service delivery strategy by which a government or not-for-profit organization hires one or more outside entities to provide all or part of a service.

Contractor. An individual or organization having a contract to provide services with a government or not-for-profit organization.

Cost-effectiveness. A performance measurement indicator that compares the cost per unit of service to the outcomes of service delivery (for example, cost per student educated compared to the percentage of increase in test scores).

Direct costs. Costs that can be assigned specifically to the target function or activity. If the target function or activity were to cease, the direct costs would also cease.

Divestiture. An alternative privatization action resulting from the introduction of competition. Involves service shedding or asset sale or lease strategies. This action results in the government or not-for-profit organization reducing the level of service or discontinuing the service altogether.

Efficiencies. A performance measurement indicator that compares the cost or other inputs per unit of service delivery to the outputs to measure service delivery efficiency (for example, number of children inoculated per $1,000 of cost).

Evaluation committee. Representatives of management and other interested parties responsible for acting on the provider recommendation of the competition task team.

Franchising. A competition strategy and form of outsourcing that involves a government or not-for-profit organization granting an exclusive right to a private business to provide a government or not-for-profit organization service in a certain geographical area.

Full costs. The sum of all in-house costs necessary to operate the target function or activity, including both direct and in-direct costs.

Full-time equivalents (FTE). The equivalent of an employee who works a minimum of 2,080 hours per year based on a forty-hour workweek.

Indirect costs. Costs necessary for the functioning of the organization as a whole that benefit the target function or activity, but that cannot be directly assigned to the target function or activity.

In-house costs. The costs to be incurred by retaining the target function or activity and not outsourcing.

Inputs. A performance measurement indicator of the amount of resources, both financial and personnel, used to deliver a service.

Managed competition. A competition strategy whereby a government or not-for-profit agency or department can compete with outside entities to provide a service or program.

Outcomes. A performance measurement indicator that measures the effectiveness of the service provided (for example, the percent decline in child diseases).

Outputs. A performance measurement indicator of the number of units produced or level of service provided (for example, number of children inoculated).

Outside costs. The costs to be incurred by transferring the target function or activity to a new contractor or provider, including costs associated with contract support and monitoring.

Outsourcing. An alternative privatization action resulting from competition. Involves using an outside entity to deliver a target function or activity's service in which the government or not-for-profit organization remains responsible for the service delivery.

Performance monitoring plan. A plan that identifies service measurement indicators and desired levels of performance and includes the methods of monitoring these measures for inclusion in the RFP and provider contract.

Personnel plan. A plan that addresses the potential impact on employees from a change in the service provider. The objective of the plan is to accomplish changes in the least disruptive manner.

Private sector. For purposes of this publication, refers to for-profit businesses to distinguish them from government and not-for-profit organizations.

Privatization. Broadly, actions resulting from competition where the government or not-for-profit organization shifts service delivery to an outside contractor or provider. Outsourcing and divestiture are the more specific actions resulting from consideration of privatization.

Qualitative analysis. An analysis of certain factors to determine whether a target function or activity is a good candidate for the introduction of competition.

Reengineering. An alternative action resulting from competition whereby the organization's operations are evaluated and retained in-house but restructured and streamlined to improve effectiveness and efficiency and become more competitive.

Relevant costs. The costs that can be avoided or eliminated if the target function or activity is transferred to another provider and no longer performed in-house.

Request for proposal. A competitive solicitation method used to contract for goods or services. Submitted to interested service providers to gather competitive information and bids to evaluate in the competition process.

Retention. An alternative action resulting from competition whereby the organization's operations are evaluated from a competition standpoint, but the organization decides to retain the targeted service under its present structure with little or no modification.

Service shedding. A competition strategy and form of divestiture in which the government or not-for-profit organization reduces the level of service provided or stops providing a service altogether. Private-sector businesses or other governments or not-for-profit organizations may step in to provide the service if there is a market demand.

Stakeholders. Individuals or groups interested in the results of the competition process into the target function or activity. Stakeholders include elected officials or board members, employees, customers, constituents, taxpayers, clients, and donors.

Sunk costs. Costs that have already been incurred that will not be recovered if the target function or activity is transferred to a new contractor or provider.

Target function or activity. A government or not-for-profit organization's service or program that has been selected for considering the introduction of competition.

Transition logistics plan. A plan that addresses how service delivery would be actually changed to a new outside provider, including capital assets involved, and lease or other contract obligations affected. The plan's objective is to accomplish service transition with as little disruption in service to the service recipient.

Unavoidable costs. The in-house costs that benefit the target function or activity but cannot be avoided or eliminated if the targeted service is provided by another entity.

Volunteerism. A competition strategy and form of outsourcing that involves volunteers performing all or a part of a government or not-for-profit organization's function or activity.

Vouchers. A competition strategy and form of outsourcing that involves financial subsidies given to individuals for purchasing goods or services from the available providers. A government or not-for-profit organization gives individuals certificates or vouchers to purchase the goods or services in open market.

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