



## The Legislature Could Strengthen State's Privatization Accountability Requirements

### *at a glance*

In recent years, Florida has substantially increased its use of privatization to provide public services. When carefully managed, privatization can produce important benefits for taxpayers. However, recent studies have identified weaknesses in agency privatization efforts. The Legislature could enhance privatization initiatives through its appropriations and oversight functions by

- mandating the use of "business cases" for agency privatization proposals that the Legislature could review and approve to assure that the proposals are soundly planned;
- strengthening requirements for performance-based contracts; and
- strengthening oversight of agency privatization initiatives.

### Scope

Pursuant to s. 11.511, *Florida Statutes*, the OPPAGA Interim Director initiated this project in response to a legislative request to identify factors that the Legislature should consider when agencies propose to privatize their services. Accordingly, this report focuses on steps the Legislature can take to create an environment for agencies to appropriately use privatization as a

means to improve the efficiency and effectiveness of government services.

In developing this report, we considered the findings and recommendations of prior OPPAGA reports regarding state agency privatization initiatives as well as reports by the Auditor General and other state and federal agencies. A list of OPPAGA reports that address agency privatization initiatives can be found on our website.<sup>1</sup>

### Background

Privatization is generally defined as any process aimed at shifting functions and responsibilities, in whole or in part, from the government to the private sector. Privatization encompasses a variety of techniques and activities that promote more involvement of the private sector in providing services that have traditionally been provided by government. These techniques and activities include

- contracting out, in which a private sector company or non-profit organization is hired to perform all or a portion of selected government programs and services;
- outsourcing, in which a government entity remains fully responsible for the provision

<sup>1</sup> OPPAGA has issued 78 reports from 1996 to 2003 that have addressed privatization of programs and services: <http://www.oppaga.state.fl.us/reports/privatization.html>.

## Information Brief

of affected services and maintains control over management decisions, while another entity operates the function or performs the service; and

- public-private partnerships, in which a contractual arrangement is formed between government and a private sector company to perform activities that involve the company in developing, financing, and operating a public facility or service.

When appropriately managed, privatization can produce substantial benefits for taxpayers, including saving public dollars and improving service quality. As noted in a 1998 OPPAGA report, the private sector may be able to perform services in many areas at a lower cost than government agencies due to lower labor costs, greater use of technology, fewer bureaucratic procedures and functions, and the ability to react more quickly to changing conditions.<sup>2</sup> OPPAGA often has recommended privatization as a policy option to reduce program costs or improve services.<sup>3</sup>

However, the benefits of privatization may be lost if privatization initiatives are poorly conceived or implemented. The state generally has less direct control of a function that has been privatized. Public resource accountability can suffer if the state has not carefully specified the services to be provided, established effective cost controls, and created strong systems to monitor contractor performance. Failures to meet these requirements can result in service quality problems, higher long-term costs, and disruptions in essential state services.

---

<sup>2</sup> *Assessing Privatization in State Agency Programs*, [Report No. 98-64](#), February 1999.

<sup>3</sup> For examples, see *Best Financial Management Practices Review of the Duval County School District*, [Report No. 03-41](#), August 2003; *Progress Report: Some Motor Vehicle Services Recommendations Addressed; No Action Taken on Outsourcing Mobile Home Regulation, Subsidies from Title Fees, and Rebuilt Vehicle Disclosure*, [Report No. 02-51](#), October 2002; *Justification Review: Sale of Lottery Products Program, Department of the Lottery*, [Report No. 02-11](#), February 2002; *Special Report: Children's Medical Services Privatization Is Feasible; Could Save Over \$18 Million, But Barriers Must Be Overcome*, [Report No. 02-04](#), January 2002; and *Justification Review: General Revenue Savings Possible in Consumer Protection Program*, [Report No. 01-51](#), November 2001.

<sup>6</sup> *Road Map to Excellence in Contracting*, Executive Office of the Governor Chief Inspector General, [Report No. 2003-3](#), June 2003.

Concerns regarding state agency implementation of privatization were underscored in a recent report by the Governor's chief inspector general.<sup>6</sup> This report reviewed findings from approximately 100 audits and examinations at seven Governor's agencies conducted by OPPAGA, the Auditor General, and agency inspectors general. The chief inspector general identified several major deficiencies in agency contracting practices, including

- a lack of centralized statewide direction, which has led to inconsistent and deficient contracting practices;
- lack of formal guidance for performing and documenting needs assessments for privatizing services;
- no statewide system to train or certify agency contracting personnel;
- little sharing of best contracting practices among agencies; and
- inadequate systems for monitoring and rating vendor performance.

The chief inspector general's report recommended that the Department of Management Services and other state agencies take various actions to address these concerns, including monitoring outsourcing practices for inadequacies and inconsistencies, establishing a statewide training initiative, creating a uniform vendor monitoring and rating system, and developing procedures for agencies to perform and document privatization needs assessments. It also recommended that the Department of Management Services, with the support of other state agencies' procurement staff, propose legislative changes that would strengthen agency contracting processes.

While we concur with these recommendations, the Legislature could take additional steps to improve state privatization policies and strengthen its oversight of agency privatization initiatives. These steps are described in the following section.

# Steps to Enhance Privatization Initiatives

The Legislature can play a critical role in enhancing privatization initiatives through its legislative and oversight functions by

- mandating the use of “business cases” for privatization proposals, which the Legislature could review and approve to assure that these proposals are soundly planned;
- strengthening requirements for performance contracting; and
- strengthening oversight of agency privatization initiatives.

## *The Legislature could mandate the use of “business cases” for privatization proposals*

Studies have shown that agencies need to systematically plan privatization initiatives and

evaluate the expected costs and benefits before carrying out these efforts.<sup>7</sup> Such evaluations help maximize the potential that privatization will be successful.

To strengthen the evaluation of the costs and benefits of privatization efforts, the Legislature could require agencies to develop a business case when proposing to privatize a program or services. A business case is a structured proposal that functions as a decision package for policy makers. Exhibit 1 describes the elements that should be in business cases for agency privatization efforts.

<sup>7</sup> For examples, see *Special Review: Outsourcing Pension Plan’s Outreach Services Would Not Be Cost-Effective*, [Report No. 03-61](#), November 2003; *Justification Review: Environmental Laboratory Privatization Feasible; Cost Savings Are Uncertain*, [Report No. 01-65](#), December 2001; and *Performance Review: Privatizing Regulation of Professional Engineers Has Improved Services, But Increased Costs*, [Report No. 99-42](#), March 2000.

### Exhibit 1

#### Agency Business Cases for a Privatization Proposal Should Contain Several Elements

Business Case Element	Components
Description and rationale	<ul style="list-style-type: none"> <li>▪ a description of the program or service to be privatized</li> <li>▪ an analysis of the agency’s current performance and associated needs or problems, and proposed solutions</li> <li>▪ the benefits such as cost savings or program improvements that are expected to result from privatization</li> </ul>
Cost-benefit analysis	<ul style="list-style-type: none"> <li>▪ current direct and indirect expenditures for the program or services. Indirect costs, also referred to as overhead costs, include providing executive direction, legal services, and administrative support services such as personnel, finance, and budgeting. Indirect costs also include program direction, monitoring, and other activities that are essential to operating a program, but are not directly associated with providing a service. If a program is privatized, the direct costs (such as the salaries and benefits of employees formerly providing the service) will be eliminated. However, indirect costs (comprising the salary, benefits, and expenses of the individuals overseeing the contractor) will usually remain.<sup>1</sup></li> <li>▪ a cost-benefit analysis demonstrating the potential savings or increased costs that are expected to occur under privatization. This should include a sensitivity analysis to identify critical factors that could affect the potential savings and the effect of changes in these factors on costs and benefits of the proposal, and a list of state assets that would be transferred to the contractor if the plan is implemented.</li> <li>▪ If applicable, a description of the methodology that will be used to calculate savings and payments to a contractor under a share-in-savings contract.<sup>2</sup> A proposed share-in-savings contract also should describe quantifiable baseline data that will be used to establish the basis upon which the percentage of savings paid to a contractor will be determined.</li> </ul>
Contract monitoring and contingency plans	<ul style="list-style-type: none"> <li>▪ the process the agency plans to use to monitor contractor performance and the estimated monitoring costs the agency will incur for this oversight</li> <li>▪ a contingency plan specifying actions that will be taken to address potential problems, such as vendor prices being higher than expected, unexpected contractor delays in performing services by required deadlines, failures to meet performance expectations, or the contractor being unable to meet obligations and/or abandoning the contract.</li> </ul>
Public records access	<ul style="list-style-type: none"> <li>▪ a list of public record issues, including whether any records to be maintained by the contractor are deemed to be non-public records and the procedures that will be used to ensure that the contractor maintains security and privacy of sensitive information</li> <li>▪ agency plans to require the contractor to provide access to records. Private contractors should be required make available for review any program-related record that it produces or collects to the same extent those records would be available from a state agency.</li> </ul>

<sup>1</sup> *PB<sup>2</sup> Commentary: Florida’s Unit Cost Initiative Shows Promise, But Needs Further Development*, [Report No. 01-05](#), January 2001.

<sup>2</sup> A share-in-savings contract is an agreement in which an agency pays a contractor based on the financial benefits derived from the contractor’s performance.

Source: OPPAGA analysis.

## Information Brief

Since privatization generally affects the use of appropriated funds and program performance, the Legislature should consider reviewing and approving major agency privatization proposals. The Legislature is responsible for establishing state policies by enacting laws, appropriating funds to finance state programs, and overseeing the implementation of programs by state agencies. Substantive committees, appropriation committees, or the Legislative Budget Commission could perform these reviews.

### ***The Legislature could strengthen performance contracting requirements***

Numerous studies have found that it is crucial for state agencies to establish strong mechanisms for monitoring contractor performance.<sup>8</sup> Strong monitoring mechanisms are needed to help ensure that privatization produces expected benefits and contractors provide Florida citizens quality services in a cost-effective manner.

To improve the monitoring of contractor performance, the Legislature could amend Ch. 287, *Florida Statutes*, to require agencies to develop performance contracts with companies or service providers that include

- performance measures and standards; these performance measures should include output, outcome, and unit cost measures; the contracts should specify performance standards for each measure;<sup>10</sup>
- incentives and penalties to ensure contractor

<sup>8</sup> For examples, see *Progress Report: Florida Engineers Management Corporation Performs Well, But Department of Business and Professional Regulation Has Not Implemented Privatization Recommendations*, [Report No. 02-38](#), June 2002; *Progress Report: DMS Adopts OPPAGA's Workforce Recommendations; However, a Strong Outsourcing Contract Is Imperative*, [Report No. 01-33](#), July 2001; *Special Review: Feasibility of Outsourcing Florida's Statewide Retirement Systems*, [Report No. 01-12](#), February 2001; *Private Prison Review: South Bay Correctional Facility Provides Savings and Success; Room for Improvement*, [Report No. 99-39](#), March 2000.

<sup>10</sup> Output measures assess the level of services or products delivered by a state agency, while outcome measures identify the results and impacts of the services. Unit costs represent the costs of producing an output or outcome.

- compliance with contract terms and the achievement of expected performance results;
- provisions providing access to contractor data by government agencies and the public; and
- regular reporting of progress in achieving performance standards and outcomes specified in the contracts.

The Legislature could also

- require agencies to establish systems for monitoring contractor performance and compliance with contract terms and conditions, and
- require the Department of Management Services to develop a database of lessons learned in privatizing government programs and services and disseminate this information to state agencies.

### ***The Legislature could strengthen oversight for privatization***

It is also important for the Legislature to exercise oversight in determining whether privatization initiatives are being administered in accordance with state laws and policies and whether state laws and policies relating to privatization are achieving their intended results.

Accordingly, the Legislature could strengthen oversight by

- requiring agencies to annually evaluate contractor performance for major privatization initiatives and report their findings to the Legislature and OPPAGA and/or the Auditor General, and
- directing OPPAGA and/or the Auditor General to periodically examine major privatization initiatives to help the Legislature to evaluate whether expected outcomes and savings have been achieved.

The Legislature also could direct OPPAGA and/or the Auditor General to conduct implementation assessments that monitor major privatization initiatives and submit periodic reports to give the Legislature independent information on their status.

---

OPPAGA provides objective, independent, professional analyses of state policies and services to assist the Florida Legislature in decision making, to ensure government accountability, and to recommend the best use of public resources. This project was conducted in accordance with applicable evaluation standards. Copies of this report in print or alternate accessible format may be obtained by telephone (850/488-0021 or 800/531-2477), by FAX (850/487-3804), in person, or by mail (OPPAGA Report Production, Claude Pepper Building, Room 312, 111 W. Madison St., Tallahassee, FL 32399-1475).

**Florida Monitor:** <http://www.oppaga.state.fl.us/>

Gary VanLandingham, OPPAGA Interim Director