

Key Points of Report

An Audit Report on the State's Contract Workforce

February 1999

Overall Conclusion

Information is not adequate and improved agency management practices are needed to manage the State's \$1.2 billion contract workforce better. State leaders need more useful and reliable information on the entire workforce (state employees and contract workers) to make informed decisions about the size of state government.

While the Legislature has made an effort to control the number of state employees, there has been an increase in the amount state agencies spend on contract workers. Contract workforce expenditures have increased 58 percent over the last five years, while expenditures for state salaries and benefits have increased only 14 percent. There are many valid reasons for using contract workers, but there could be serious consequences if contract workers are not appropriately used and managed.

Key Facts and Findings

- The data state entities submit for Full-Time Equivalent reports and the Uniform Statewide Accounting System should be modified to improve information on the State's contract workforce. Also, not all agencies are collecting accurate information about the number of contract workers, length of tenure, or pay for services. Often, this information is not easily accessible at agencies.
- Agencies should better manage their contract workers by performing regular cost/benefit analyses prior to hiring contract workers, applying comprehensive policies and procedures to manage and monitor contract workers, and consistently monitoring legal risks to avoid potential liability related to contract workers.
- While many agencies use contract and temporary workers for seasonal surges in work or unique assignments, some contract workers have worked at the same agency for as long as nine years.
- In many instances, former state employees have returned to state government as contract workers usually resulting in higher costs to the State for professional positions. At the Office of the Comptroller of Public Accounts, former state employees made up approximately 9 percent of the contract workforce. Rather than directly contracting with the State, these workers typically are employed by companies that contract with the State, resulting in company contract workers who are not subject to related state regulations.

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Executive Summary

Information is not adequate and improved agency management practices are needed to manage the State's \$1.2¹ billion contract workforce better. State leaders need more useful and reliable information on the entire workforce (state employees and contract workers) to make informed decisions about the size of state government.

While the Legislature has made an effort to control the number of state employees, there has been an increase in the amount state entities spend on contract workers. Contract workforce expenditures have increased 58 percent (from \$758 million to \$1.2 billion) over the last five years, while expenditures for state salaries and benefits have increased only 14 percent (from \$6.9 billion to \$7.9 billion). There are many valid reasons for using contract workers, but there could be serious consequences if contract workers are not used and managed appropriately.

Changes Are Needed to Improve Contract Workforce Information

While four statewide databases contain some type of contract worker information, the two primary databases for collecting information on the

¹Statewide dollar amounts represent net expenditures for selected object codes as recorded by the Uniform Statewide Accounting System (USAS). The State Auditor's Office selected the 25 expenditure categories that appeared most inclusive of consultants and contractors. In some cases, dollar expenditures may not be recorded in the correct USAS object code due to the complexities of the USAS codes for contract workers and a lack of consistent reporting by agencies. Therefore, these dollar figures may be either overstated or understated.

State's contract workforce are the Uniform Statewide Accounting System and the Full-Time Equivalent Reporting System. However, these two databases do not correlate because of unclear reporting definitions, the difficulty of capturing contractor headcount information, and inconsistent reporting by agencies. Consequently, the usefulness of the databases to assist the Legislature in making decisions regarding the size of the State's workforce is limited.

To improve data on the contract workforce, the Legislature should consider eliminating or modifying the requirement of state entities to report the number of contract workers. Consistent, reliable data on the number of contract workers or hours worked is difficult to obtain for all types of contract workers. Then, the Office of the Comptroller of Public Accounts (Comptroller) should collaborate with the State Auditor's Office and other state agencies and universities to modify Uniform Statewide Accounting System (USAS) codes so that more useful and accurate expenditure data on contract workers can be accumulated.

Agencies Should Implement Comprehensive Management Practices for Developing and Monitoring Their Contract Workforce

Agencies reviewed had not consistently performed cost/benefit analyses, collected and monitored contract worker data, applied comprehensive policies and procedures, and monitored legal risks to effectively manage their contract workforce. Consequently, it is difficult to determine if the use of contract workers is always in the

Executive Summary

State's best interest. Agencies need to strengthen management practices to ensure that the contract workforce is providing high-quality, cost-effective services.

Agencies Should Monitor the Risks of Developing Long-Term Relationships With Contract Workers

While some of the agencies audited use contract and temporary workers for seasonal surges in work or unique assignments, others established long-term relationships with the same contract workers (nine years in one example). These long-term relationships could result in increased costs through legal liability or through high turnover and low morale of state employees.

Who makes up Texas' contract workforce?

- **Temporary workers supplied by staffing companies:** Individuals who are employed by a private "temp" company and are assigned, usually for a specified period of time, to particular and various clients
- **Independent contractors:** Individuals who have a contract directly with a state agency or institution
- **Contract company workers:** Individuals who work for a contract company and who, like temps, are assigned to particular and various clients
- **Consultants:** Individuals who provide a certain type of informational expertise to a client

The State Should Eliminate Incentives for State Employees to Return as Contract Workers at a Higher Cost to the State

Many state employees quit state employment, go to work for contractors doing business with the State, and earn

higher salaries. This results in higher costs to the State and a loss of valuable institutional knowledge at state entities. Often, this applies to professional positions in information technology for which state salaries have not kept up with the market.

At the Comptroller's Office, former state employees made up approximately 9 percent of the 347 workers identified in its contract workforce. Further, current reporting requirements do not apply to former state employees who become employed by companies contracting with the State. These requirements only apply to persons contracting directly with the State. This issue highlights the need for salary adjustments as discussed in previous SAO reports.²

Whom did we audit and why?

We focused on long-term contract and temporary workers who work alongside state employees. Contract workers present important issues that agencies must learn to manage, and many of these issues apply to these specific types of contract workers. The agencies selected were in the top 20 in terms of contract worker expenditures. The following agencies were audited:

- Office of the Attorney General
- Comptroller of Public Accounts
- Department of Human Services
- Parks and Wildlife Department
- Workforce Commission

Summary of Managements' Responses

The audited agencies generally concurred with most issues and recommendations in the report. Their responses begin on page 16.

²A *Biennial Report on Recommended Changes in the Position Classification Plan* (SAO Report No. 98-706) and *A Biennial Report on Recommended Adjustments to the Classification Salary Schedules* (SAO Report No. 98-708)

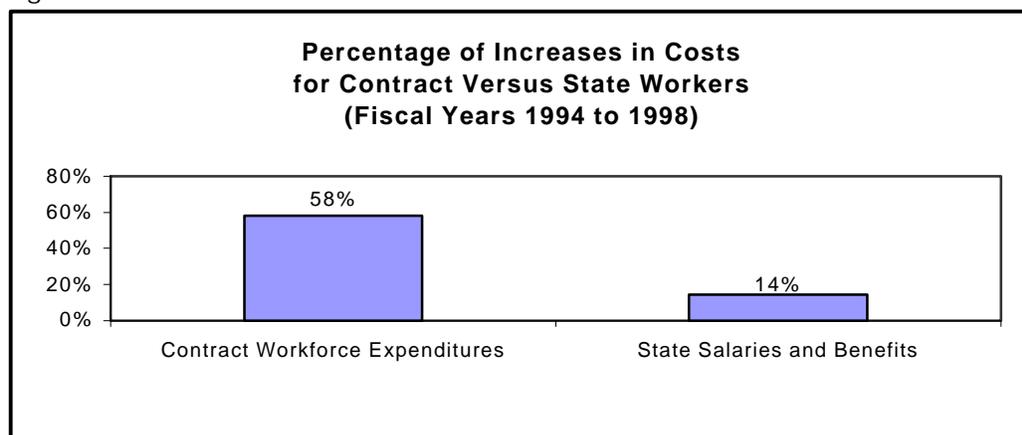
Overall Conclusion

Information is not adequate and improved agency management practices are needed to manage the State's \$1.2 billion³ contract workforce better. State leaders need more useful and reliable information on the entire workforce (state employees and contract workers) to make informed decisions about the size of state government. Also, agency managers need better information to manage their own workforce.

While the Legislature has made an effort to control the number of state employees, there has been an increase in the amount state entities spend on contract workers. Contract workforce expenditures have increased 58 percent (from \$758 million to \$1.2 billion) over the last five years, while expenditures for state salaries and benefits have increased only 14 percent (from \$6.9 billion to \$7.9 billion). See Figure 1.

As a result, the makeup of the State's total workforce is changing. Now contract workers hold a larger portion of the total workforce than they did in the past. While there are many valid reasons for using contract workers, there could be serious consequences if contract workers are not appropriately used and managed.

Figure 1



Source: Uniform Statewide Accounting System

Section 1:

Changes Are Needed to Improve Contract Workforce Information

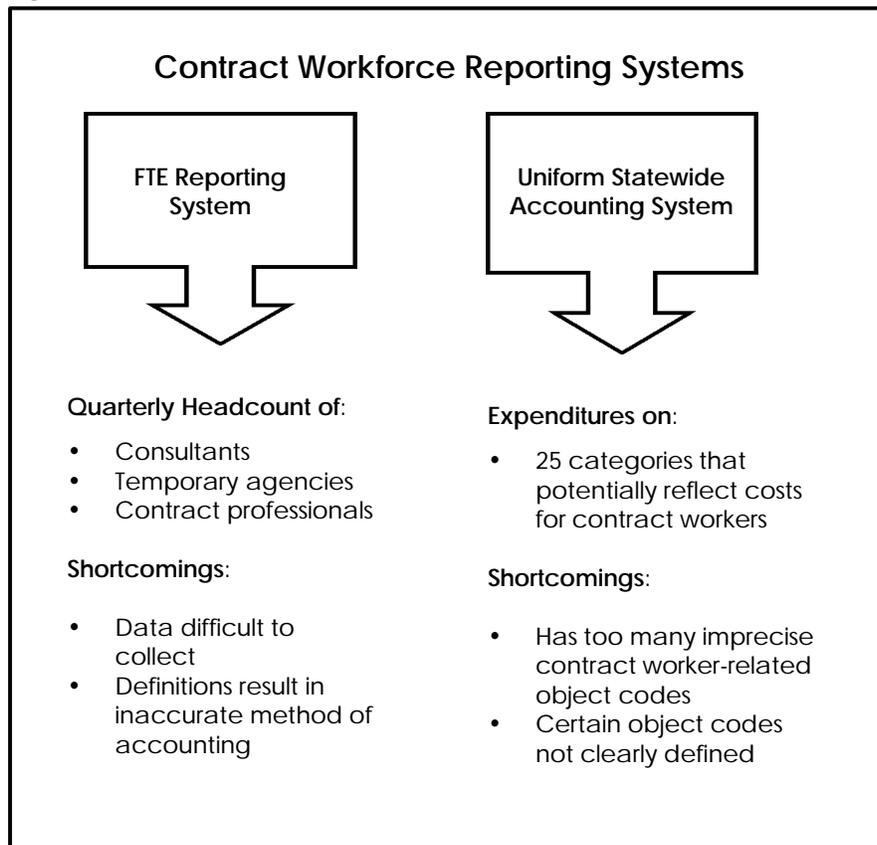
The information currently reported on the number of contract workers is unreliable, and related expenditure data should be improved. Without accurate information, state leaders cannot make informed decisions about the State's overall workforce.

³Statewide dollar amounts represent net expenditures for selected object codes as recorded by the Uniform Statewide Accounting System (USAS). The State Auditor's Office selected the 25 expenditure categories that appeared most inclusive of consultants and contractors. In some cases, dollar expenditures may not be recorded in the correct USAS object code due to the complexities of the USAS codes for contract workers and a lack of consistent reporting by agencies. Therefore, these dollar figures may be either overstated or understated.

The State currently has comprehensive, reliable data on state employees including expenditures, full-time equivalent data, and employee headcount. This straightforward information is collected through the Uniform Statewide Accounting System (USAS) and the Full-Time Equivalent (FTE) Reporting System.

By contrast, four statewide databases contain some type of contract worker information, but the information is much less straightforward. The databases include the Uniform Statewide Accounting System, the Full-Time Equivalent Reporting System, and databases maintained by the Legislative Budget Board and the General Services Commission. The two primary databases for collecting information on the State's contract workforce are USAS and the FTE Reporting System. However, these two databases do not correlate because of unclear reporting definitions, the difficulty of capturing contractor headcount information, and inconsistent reporting by agencies. (See Figure 2.)

Figure 2



Source: FTE Reporting System and USAS

Inconsistent and incorrect reporting by agencies makes statewide analysis difficult and not as meaningful as it could be. First, there are too many USAS codes for contract worker expenditures, and some object codes are not clearly defined.

Secondly, this information cannot be easily or completely collected for all types of contract workers. Agency data on contract workers is typically decentralized at the departmental level. While data on temporary agency workers and independent contractors is generally available, other contracts, particularly consultant contracts and company contract workers, focus on

services performed rather than the number of workers or hours worked. This data is not readily available.

Finally, current requirements for reporting full-time equivalent data for contract workers require a headcount as of the last day of each quarter. This method does not

take into account the number of contractor workers or amount of time they worked throughout the quarter, as does full-time equivalent data on state employees. As a result, reported headcount data does not accurately present the size of the State's contract workforce throughout the year. For example, a secretary from a temporary agency who was present on the last day of the quarter, but only worked two days, would be counted as one entire contract worker for the quarter rather than only 16 hours.

Recommendation:

The Comptroller should modify the USAS object codes to provide more useful information on the contract workforce. These modifications should be made through a collaborative effort involving the Comptroller's Office, various agency and university representatives, and the State Auditor's Office. To improve the usefulness of the contract workforce information the work group should consider:

- Simplifying and clarifying USAS codes related to the contracted workforce
- Clarifying USAS definitions for codes related to the contracted workforce
- Eliminating unnecessary USAS codes

These changes should be made effective September 1, 1999.

The Legislature should consider changing Texas Government Code, Chapter 2052, Subchapter B:

- Option 1: Eliminate the requirement of reporting consultants and other contract workers. With some improvements, the contract worker expenditure information in USAS would provide information on the entire workforce and reduce the need for information on the number of contractors.
- Option 2: Modify the current reporting requirements for contract workers. If the Legislature wants to collect partial information on the number of contract workers, the FTE reporting requirements should be modified. The modified requirements should capture information only on temporary employment agency workers and independent contractors, which is fairly easy to identify. As an alternative, the Legislature may want to consider capturing the number of hours worked to determine equivalent full-time contract workers. Explanations of why full-time equivalent contractors cannot be determined, the types of services, and the dollars spent may also need to be reported.

Section 2:

Agencies Should Implement Comprehensive Management Practices for Developing and Monitoring Their Contract Workforce

Agencies have not consistently performed cost/benefit analyses, collected and monitored contract worker data, developed comprehensive policies and procedures, or monitored performance of contract workforce services. Consequently, it is difficult to determine if the use of contract workers is always in the State's best interest. Agencies should strengthen their management practices to ensure that the contract workforce is providing high-quality, cost-effective services.

Section 2-A:

Agencies Should Perform Regular Cost/Benefit Analyses Prior to Hiring Contract Workers

Some state agencies audited were doing little or no up-front analysis before opting to use contract workers rather than hire state employees. Without this analysis, agency managers are more likely to make costly mistakes, and they are unable to demonstrate that workforce decisions were made after carefully weighing the costs and benefits of available options.

Managers at the Comptroller's Office reported that they consider cost/benefit factors although the process was not formally documented. They reported that clerical positions were generally cheaper to contract out. Cost comparisons performed for this audit confirmed their assertion. On the other hand, professional positions were generally cheaper to fill with state employees.

Table 1 compares the cost of hiring state employees versus contract workers for the same types of work. This is an example of some of the analyses agencies should perform when considering alternatives.

Table 1

Comparison of Hourly Wages (Bold Indicates Least Expensive Worker)			
Agency	Job Classification	State Employee Cost ^a	Contractor Cost ^b
Office of the Attorney General	Administrative Technician	\$12.24 to \$15.58	\$11.02
	Programmer/Analyst	\$25.86 to \$34.63	\$65.25
Comptroller of Public Accounts	Clerk	\$ 8.81 to \$12.26	\$8.40
	Systems Analyst	\$31.31 to \$41.99	\$69.00
	Programmer/Analyst	\$25.86 to \$36.91	\$63.00
	Receptionist/Typist	\$10.38 to \$13.02	\$9.00
Department of Human Services	Receptionist	\$10.38 to \$13.02	\$6.38 to \$9.23
	Data Entry Operator	\$10.97 to \$13.80	\$6.84 to \$9.68
	Secretary	\$11.58 to \$14.68	\$7.39 to \$11.10

Table 1, concluded

Comparison of Hourly Wages (Bold Indicates Least Expensive Worker)			
Agency	Job Classification	State Employee Cost ^a	Contractor Cost ^b
Department of Human Services	Programmer/Analyst	\$25.86 to \$34.63	\$79.38
	Programmer/Analyst	\$27.55 to \$36.91	\$90.72
Parks and Wildlife Department	Fee Collector	\$8.85 to \$10.97	\$8.75 to \$9.12
	Reservations Agent	\$9.85 to \$12.26	\$8.10 to \$8.40
Workforce Commission	Data Entry Clerk	\$10.97 to \$13.80	\$8.74
	Telecommunications Specialist	\$17.69 to \$34.62	\$50.00 to \$75.00
	Programmer/Analyst	\$17.69 to \$41.99	\$54.81 to \$85.00
^a Includes salary and benefits. ^b Includes wages and overhead. Ranges include minimum and maximum contract amounts the agency has agreed to pay. Minimum or maximum amounts may not represent actual payments to vendors; however, vendors are paid within the range.			

Sources: Agency Files, State Classification Salary Schedule, and State Classification Office Benefit Estimates

However, managers have difficulties in filling agency vacancies for information technology professionals. Managers found it difficult to find qualified professionals willing to accept state salaries that are below market. For example, the Comptroller of Public Accounts was unable to generate interest from qualified applicants for four information technology positions reviewed.⁴

At the Workforce Commission, managers analyze costs and benefits associated with hiring contract workers to perform seasonal work when workloads increase. Based on a cost study, the Workforce Commission estimates it saves approximately \$286,000 per year by contracting with a vendor for seasonal work rather than directly hiring temporary state employees as it did prior to 1996.

At the Office of the Attorney General, costs are not generally considered in deciding whether to use contract workers. Management attributed the increase in its use of contract workers to an increase in caseloads and collections, a budget shortfall, and the inability to hire information technology workers at state salary rates. Despite the increasing workload, the Office of the Attorney General has been below its FTE cap by approximately 92 to 144 employees during fiscal year 1998.

At the Department of Human Services, as with other agencies audited, there were no set policies and procedures on how to conduct cost comparisons. However, managers in one division indicated that they fund their contract workers from vacant positions based on available budget dollars. Since all temporary workers come out of each division's budget, there is motivation to ensure they are getting their money's worth.

⁴This issue highlights the need for salary adjustments as discussed in previous SAO reports: *Biennial Report on Recommended Changes in the Position Classification Plan* (SAO Report No. 98-706) and the *Annual Report on Full-Time Classified State Employee Turnover For Fiscal Year 1998* (SAO Report No. 99-702).

At the Parks and Wildlife Department, management indicated it would like to use contractors for seasonal work instead of its current practice of hiring state employees for seasonal work. Management indicated that the costs associated with hiring a state employee for four months or less are higher than for contract workers. These seasonal state employee costs included paper work processing for benefits such as annual leave, sick leave, and pension enrollment.

While cost is an important consideration, it is not the only one. Agencies should also consider productivity of workers when performing their cost/benefit analysis. Agencies should consider other benefits and costs of using contract workers. For example, hiring a contract worker could give the agency more flexibility for seasonal surges in work. At the same time, hiring a state employee could ensure more consistency in the job performed and less need for constant re-training and corrections. (See the *Best Practices and Guidelines for Effectively Using a Contract Workforce*, SAO No. 99-326, to be released in March 1999, for detailed information on how to perform a cost analysis while considering productivity.)

Recommendation:

State agencies and institutions should conduct a thorough cost/benefit analysis as part of their overall staffing strategies. When conducting cost/benefit analyses, agencies should consider many factors including wages, benefits, overhead, and productivity. (The *Best Practices and Guidelines for Effectively Using a Contract Workforce* provides detailed information on how to determine and compare unit labor cost for contract and core workers, determine training costs for contract workers, and determine the cost-effectiveness of contract labor.)

Section 2-B:

Agencies Need Readily Available Contract Worker Data to Manage and Monitor Their Workforce

Obtaining consistent, accurate, or complete information to answer questions about the size and make-up of the contract workforce for this report was difficult and time consuming. Without readily available or easily accessible information, state agencies cannot make timely, informed management decisions about their contract workers. While most of the agencies audited were eventually able to obtain the information requested (the number of contract workers, length of tenure, and pay for services), the information did not appear to be readily available to them.

The Office of the Attorney General does not have a system or standard procedure in place to adequately identify and track the numbers and positions of contract workers. It was not able to provide complete information about its contract workforce. As a result, the number of contract workers identified during the audit is likely understated because the information is scattered and not consistently tracked. Further, the Office of the Attorney General was unable to provide information on tenure for administrative temporary workers.

Table 2

Number of Contract Workers at Audited Agencies		
Agency	Accounted in FTE Report	Identified During Audit ^a
Office of the Attorney General ^b	280	327
Comptroller of Public Accounts	376	347
Department of Human Services ^c	606	253
Parks and Wildlife Department ^d	139	40
Workforce Commission ^e	41	82

^aThe audited number includes long-term contract and temporary workers who work alongside agency employees and were the focus of our audit.

^bThe audited number is likely understated because the agency did not provide us with complete information on its use of information technology professionals.

^cA surge in the number of contractors during the fourth quarter caused a discrepancy. The number reported in the FTE Report includes contractors working in regional offices; the number identified in the audit does not.

^dSeasonal surges in the number of contractors during the summer months caused discrepancies.

^eReporting discrepancies are caused by reporting the number of contracts rather than the number of contract workers. Many administrative contract workers are seasonal, and they only work an average of two-week intervals (totals two months per year).

Sources: FTE Reporting System and Agency Records

We found inconsistencies in the numbers reported for the FTE report and the numbers identified during the audit (see Table 2). Discrepancies in these numbers can be expected, since the audit focused on contract workers who work alongside state employees and perform functions that state employees would otherwise perform. The audit did not capture the number of contracted consultants who work off-site and report information to the agency. Thus, the audited numbers may be slightly understated or less than the numbers reported by agencies in the FTE reports, since the FTE reporting definition included consultants.

Recommendation:

Agencies should ensure that they have systems in place to readily collect reliable and useful management information on their contract workforces. This information should be collected agencywide rather than at the departmental level to facilitate planning, management, and monitoring of the entire workforce.

The types of information agencies should collect includes:

- The numbers and types of contract workers used
- Tenure of contract workers at the agencies
- Costs of services provided
- Performance of contractors
- Results achieved through services provided

If certain information is not available for some contracts, agencies should examine whether that information is needed to make informed management decisions. If so, agencies should work with contractors to obtain needed information.

Once the information is readily available, agencies should use it to monitor their workforce and to make timely, informed management decisions about their contract workers.

Section 2-C:

Agencies Should Develop and Follow Comprehensive Policies and Procedures for Managing Contract Workers

None of the state agencies audited had developed comprehensive policies and procedures for managing contract workers. Without comprehensive policies and procedures, management cannot ensure that contract workers are managed as intended throughout the organization. This can lead to inconsistency in the way contract workers are managed and does not ensure the best use of resources. Policies and procedures are integral to the planning process and are essential tools for managerial direction and control.

While most of the agencies audited did have one or more policies at the divisional level, these policies were not adequate to address all contract workforce issues agencywide. The most comprehensive policies and procedures were found at the Department of Human Services. The Department of Human Services had comprehensive, agencywide policies and procedures for the use and procurement of contract workers. However, it had no set policies on how to conduct a cost/benefit analysis for contract workers.

Recommendation:

Agencies should develop comprehensive contract workforce policies and procedures which address (1) how to decide whether to use a contract worker or a regular employee; (2) how to ensure the best qualified contract workers are fairly and objectively selected; and (3) how contract workers should be managed and monitored. (See the *Best Practices and Guidelines for Effectively Using a Contract Workforce* for detailed information and checklists.)

Section 2-D:

Agencies Should Regularly Monitor and Evaluate Performance of Contract Workers

Most of the agencies audited did not have comprehensive documented policies and procedures in place to promote effective monitoring and evaluation functions throughout the agencies. Without effective monitoring and evaluation of results achieved by contractors, adequate service delivery and prudent use of state dollars cannot be ensured. Policies and procedures for management of contract workers should include guidance on how to monitor and evaluate contract workers' performance. This will ensure that they consistently provide quality services (by measuring performance against well-documented expectations) and that public funds are spent effectively and efficiently.

Past audits also have indicated that some agencies have not adequately monitored their contracts. Except for related policies and procedures, contract monitoring and evaluation were not reviewed. This issue has been covered extensively in previous audits.

Recommendation:

Agencies should develop a performance monitoring and evaluation function for contract workers. This function should:

- Focus on the outcomes of services provided and the cost-effectiveness of contractor expenditures.
- Include establishment of standardized criteria to evaluate contractor performance.
- Compare and analyze actual to anticipated results and costs.
- Ensure that the evaluation process does not lead to potential legal liability.

Section 3:

Agencies Should Monitor the Risks of Developing Long-Term Relationships With Contract Workers

While some agencies audited use contractors and temporary workers for seasonal surges in work, specialized skills, or unique assignments, others established long-term relationships with the same contract workers (nine years in one example). State agencies that develop long-term relationships with the same contract workers face potential legal liability if courts or the Internal Revenue Service rule they have an employer/employee relationship. Recent court cases and the Internal Revenue Service have highlighted the need for any entity using contract workers to use caution when defining these relationships both contractually and in practice. Finally, these long-term relationships may encourage increased costs through turnover and perpetuate the disparity in salaries between contract and state workers for vital agency functions.

The Comptroller and the Office of the Attorney General retain some contract workers for long time periods. The Comptroller has two information technology contractors who have been working at the agency for over nine years; the longest tenure for administrative temporaries was three years nine months. At the Office of the Attorney General, the longest tenure for information technology contractors was nearly six years; it does not track tenure over one year for administrative temporary workers.

The Workforce Commission, the Parks and Wildlife Department, and the Department of Human Services appropriately use temporary workers for seasonal surges in work. Workforce Commission managers have determined exactly how many workers are needed at a given time based on workload projections. The Parks and Wildlife Department uses temporary state employees to help run state parks during seasonal peaks. Finally, the Department of Human Services normally uses contract workers for a year or less.

Information technology workers and administrative temporary workers make up a large portion of the contract workforce. These types of workers often work alongside state employees. During our audit, we obtained tenure information on these two types of workers (see Tables 3 and 4).

Table 3

Tenure for Contract Information Technology Professionals		
Agency	Average Tenure	Longest Tenure
Office of the Attorney General	1 year 5 months	5 years 10 months
Comptroller of Public Accounts	2 years 1 month	9 years
Department of Human Services	10 months	4 years 2 months
Parks and Wildlife Department	1 year 2 months	3 years 2 months
Workforce Commission	10 months	2 years 3 months

Source: Agency Records

Table 4

Tenure for Contract Administrative Temporary Workers		
Agency	Average Tenure	Longest Tenure
Office of the Attorney General	Not available	Not available
Comptroller of Public Accounts	7 months	3 years 9 months
Department of Human Services	3 months	1 year 2 months
Parks and Wildlife Department	1 year 1 month	4 years 10 months
Workforce Commission	2 months	6 months

Source: Agency Records

Length of tenure is not the only criterion that authorities use to decide on the type of relationship that exists between employers and contract workers. The Internal Revenue Service has a list of 20 factors that are used along with case law to make these determinations. The more criteria that are met the more likely are these authorities to determine that an employer-employee relationship exists. In some cases, employers have been liable for employee taxes and benefits.

While length of tenure did not appear to affect management decisions, potential legal liability did at some agencies. For example, the Comptroller required that supervisory feedback come from the contracting company rather than the on-site supervisor to reduce the appearance of agency control over contract workers. This process appears cumbersome from a management perspective, but it is evidence that the agency has considered certain important legal risks pertaining to management of its contract workforce.

Legal considerations also affected a decision at the Parks and Wildlife Department to continue to use seasonal employees rather than seasonal contract workers. The agency believes its control over the work performed by these types of workers requires it to hire employees rather than contractors.

Recommendation:

Agencies should monitor and manage their long-term relationships with contract workers in light of recent and future Internal Revenue Service and court rulings to help avoid potential legal problems. Agencies should consider the effect long-term relationships with the same contract workers have on morale and turnover. Finally, agencies should ensure that contract workers are used when the cost is beneficial, for seasonal workflow increases, or when specialized expertise is needed. Further information on legal risks related to use of contract workers can be found in the *Best Practices and Guidelines for Effectively Using a Contract Workforce*.

There Should Not Be Incentives for State Employees to Return as Contract Workers at a Higher Cost to the State

In many instances, state employees resign from state employment to work as contractors for the State, which increases their salaries and the cost to the State. Typically, these former employees are in professional positions—often information technology professionals—where state salaries have not kept up with market demand.

The return of former state employees as higher-wage contractors can cause morale problems and may encourage turnover of professionals with valuable institutional knowledge. At the Comptroller's Office, former state employees made up approximately 9 percent of the 347 workers identified in its contract workforce. Rather than directly contracting with the State, these workers typically are employed by companies that contract with the State, resulting in company contract workers who are not subject to related state regulations.

In our audit, we found these occurrences of state employees-turned-contractors:

- At the Office of the Attorney General, 19 former state employees returned as information technology consultant/contractors. Two of them were former employees; the remaining 17 were from other state agencies.
- At the Comptroller of Public Accounts, 31 contractors worked for a state agency within two years prior to contracting with the Comptroller. Likewise, two contractors were found to have left the Comptroller's Office less than one year before beginning contract work at the agency.
- At the Workforce Commission, one former state employee returned as an information technology contractor. Thirty-four former state employees worked for a major temporary agency, but these temporary workers are seasonal and only work an average of two-week intervals totaling two months per year. Former Workforce Commission temporary employees were encouraged to sign up with a temporary agency so that the Commission could retain experienced workers. These temporary workers did not return at a higher cost to the State.
- At the Parks and Wildlife Department, five independent contractors were in violation of General Appropriations Act limitations of one year between state employment and contract employment. These contractors were summer swim instructors located at one park.
- At the Department of Human Services, four contract workers from a selected sample worked for another state agency within two years of contracting with the Department of Human Services. Since these workers worked for a vendor, they were not required to disclose information on their previous employment. One worker in the sample was employed by the Department of Human Services within one year, but he or she also worked for a vendor and was not subject to General Appropriations Act

requirements. All of these contract workers were information technology professionals and had previously performed this type of work for the State.

Because most of these contractors work through a vendor and do not contract directly with the agency, they are not violating state requirements regarding contracting with former state employees. However, information about these types of workers is not collected, and there is a question of whether agencies are meeting the legislative intent.

Recommendation:

The State Auditor's Office has no specific recommendations, but we think it is important to bring this information to the attention of the Legislature for consideration. Additionally, this issue again highlights the need for salary adjustments for state employees.

Managements' Responses

Office of the Attorney General

Thank you for forwarding a copy of the SAO's draft Audit Report on the State's Contract Workforce to the Office of the Attorney General (OAG) for review. The OAG appreciates having been given the opportunity to comment on the draft report; however, the agency will not be providing a formal written response to the SAO's audit, at this time. The Cornyn Administration intends to study the findings and recommendations offered in the report in further detail, and may wish to discuss the report with SAO staff in the near future.

Again, the agency appreciates the SAO's solicitation of the OAG's comments on this audit and looks forward to working with the SAO in the future.

Comptroller of Public Accounts

Thank you for giving the Comptroller of Public Accounts an opportunity to respond to the recommendations contained in the State Auditor's Office's report An Audit of the State's Contract Workforce.

We did not respond to Section 4 of the report because there was no associated recommendation. However, the following responses address the other sections of the report:

Overall Conclusion

The ability to use contract workers provides state agencies with opportunities for hiring seasonal employees for peak workload requirements, obtaining subject matter experts for short-term projects, or in many cases, obtaining services at a lower cost. The Comptroller's office agrees with the State Auditor's Office that more reliable information is needed on a statewide level in order for state leaders to make informed decisions about the state's workforce. Additional analysis of the potential risks and liabilities facing all agencies is also needed to ensure protection for the state.

Section 1: Changes Are Needed to Improve Contract Workforce Information

The Comptroller's Office agrees with this recommendation and will work with the State Auditor's Office and other parties to modify the object codes used to capture information on contract workers.

Section 2A: Agencies Should Perform Regular Cost/Benefit Analyses Prior to Hiring Contract Workers

The Comptroller's office agrees that an up-front analysis is both desirable and necessary before contract workers are hired. The agency recognizes that such an analysis should include:

- *Knowledge of labor market conditions relating to the lack of qualified workers willing to work for state wages;*
- *Knowledge of costs involved in not performing specific mandated responsibilities assigned to the Comptroller's office by state law; and*
- *Awareness of certain "judgmental" forecasts that involve information from the past to predict future conditions.*

The Comptroller's office uses the aforementioned factors in decisions to hire contract workers. Although the Comptroller's office has not used a formalized statistical cost/benefit model, we believe our informal process based on institutional knowledge produced the same results. Our previous and current use of contract workers is based on cost effectiveness and the availability of qualified state employees to perform needed functions. This report by the State Auditor's Office supports this conclusion.

In the future, the Comptroller's office will document all considerations when deciding to utilize contract workers. The State Auditor's Office's Best Practices Guide will be used as a reference in this regard.

Section 2-B: Agencies Need Readily Available Contract Worker Data to Manage and Monitor Their Workforce

The Comptroller's office agrees that information on the contract workforce should be collected and readily available. We will develop a plan to capture agency-wide information about contract workers to facilitate better management of the contract workforce. The information collected should address issues to help management determine the cost/benefit of using a state employee versus a contract worker for specific positions.

We will continue collecting data on the numbers and types of contract workers used. In addition, we will evaluate the best way to monitor the use of contract workers. We believe that tracking contracts and the services performed under them, rather than tracking individual contract workers, helps prevent establishing an employer/employee relationship and its associated liabilities.

Section 2-C: Agencies Should Develop and Follow Comprehensive Policies and Procedures for Managing Contract Workers

The Comptroller's office concurs with this recommendation. We currently have policies for dealing with contractors, however, these policies will be reviewed across the agency. We will develop and implement comprehensive policies and procedures

for managing contract workers. These policies and procedures will address potential risks of violating federal labor laws which govern the management of contract workers. The direct management of a contract worker could be construed as the development of an employer/employee relationship, which could make the agency liable for employment taxes and retirement benefits. As a result, a clear distinction will be made in the policies and procedures between the direct supervision of contract workers and the managing of contracts to ensure compliance with the contractual terms and conditions of those agreements.

Section 2-D: Agencies Should Regularly Monitor and Evaluate Performance of Contract Worker Services

We concur. See responses to Sections 2B and 2C.

Section 3: Agencies Should Monitor the Risks of Developing Long-term Relationships with Contract Workers

Although the Comptroller's office concurs with the recommendations stated in this section, it is suggested that additional analysis is necessary to fully understand the potential liabilities facing state agencies. These liabilities will ultimately be borne by the state in the form of increased litigation and legal costs due to the use of contract workers in situations in which these workers are the only source of specialized expertise available to perform essential state services.

The report does not address specific areas of legal exposure other than in the IRS context where potential liability may exist to pay employment taxes upon the finding of an employer/employee relationship with the state. There are some measures which can be taken in the contracting process to minimize the risks of state liability for employment taxes. In the area of workplace discrimination, including sexual harassment, however, it is unlikely that agencies will be able to contract away liability or responsibility to the vendor. As stated in the report, some agencies do not provide direct supervisory or other control of the contract worker in order to avoid the development of an employer/employee relationship. These agencies, therefore, do not provide the usual employee personnel protections, procedures, or processes for contract workers in respect to workplace discrimination. Additionally, claims for retirement benefits may also be made by long-term contract workers. The actual costs to pay retirement benefits, as well as the legal costs that would be incurred in defending against workplace claims could ultimately impact the cost benefit analysis conducted by state agencies in determining whether to use long-term contract workers.

The cost/benefit analysis, however, does not resolve the problem facing the state in critical areas such as technology services. Due to marketplace demands, state agencies which are dependent on technology skills must resort to using contract workers. Oftentimes, projects which implement new technologies for innovative and new statewide programs require the use of long-term contract workers in order to provide the necessary expertise and continuity for completion of the projects. Ultimately, many of the issues related to agencies use of contract workers in providing the essential services required by constitutional or legislative mandate,

such as the potential legal liabilities and the ability to offer competitive compensation to obtain specialized expertise, are matters that must be addressed on a statewide basis by the Legislature and not by individual state agencies.

Department of Human Services

The Texas Department of Human Services (TDHS) appreciates your review of the use of contract and temporary workers, including collection and reporting of relevant data and information considered when making decisions to use these workers. TDHS is committed to improving decision-making, reporting, and management processes to produce positive outcomes when using these workers. Frequently, these workers work side-by-side with TDHS employees to carry out mission-critical functions. TDHS makes every effort to ensure these workers perform at expected levels to fully support permanent staff.

Recently, in preparation for House Appropriations Subcommittee hearings, TDHS was asked to furnish comprehensive information regarding the use of contract and temporary workers. The information furnished was comparable to that collected during your audit. TDHS was careful to ensure this information was consistent, and when, in just a few instances, there were differences, they were reconciled. This information is available to you upon request.

General Response

Certain information technology (IT) skills have become scarce resources, largely due to the world-wide requirements for millennium conversion projects. Many critical projects have been postponed because of the priority of millennium conversions. This, coupled with TIES-related new systems development will ensure that the need for, and probably the scarcity of, IT skills will continue well beyond the transition to the next century. Even before the commencement of millennium conversion projects, state agencies were faced with a severe shortage of qualified programmers, analysts, and project leaders. Contractors were considered a viable solution to the State's inability to attract IT workers six or eight years ago. Recently, the increase in contract rates fueled by supply and demand and the increase in costs of millennium remediation and other time-critical projects, have drawn focused attention to the related issues.

The use of temporary workers for administrative and technical duties on a short-term basis has always been a very effective and efficient way to address short-term needs at TDHS. TDHS supervision of these workers has, in most cases, ensured acceptable performance or termination of their services. TDHS does not contract with individual temporary workers; all temporary workers are provided by temporary staffing agencies.

Specific Responses and Comments

TDHS agrees that changes in USAS object codes for contract worker expenditures should be made. Also, the FTE data reporting methodology and requirements need to be modified to ensure consistency and full disclosure.

TDHS believes that its management controls for developing and monitoring contract and temporary workers are adequate. Managers do a good job of needs assessment that leads to a cost effective decision to hire a state employee or engage a contractor. TDHS will review current processes and practices, especially in the area of documentation of needs and related decisions, and make adjustments and/or changes to ensure there is sufficient evidence to support its assertion.

The table at the bottom of page 6 of the report is too simplistic. It implies that state employees should be used for IT programmers and analysts because they are less expensive. TDHS agrees; however, at the present time availability of candidates for filling vacancies is sparse. This table is proof of the positive cost benefit of using temporary workers for receptionists, data entry operators, and secretaries.

TDHS does routinely collect information about the number of contract workers, length of tenure, and contract expenditures. This information was readily available and furnished to you at the beginning of your audit as well as to the House Appropriations Subcommittee last week. TDHS does not believe it is an efficient and effective use of resources to collect information on temporary workers at the level of detail requested during the audit. If, in fact, TDHS is required to do so, arrangements with the temporary staffing agencies will be made to provide it. Before such arrangements are made, TDHS believes you should meet with responsible Human Resources staff to ensure all necessary information in agreed-upon formats is requested.

TDHS believes any exposures to IRS sanctions in the area of employer/employee relationships are minimal. TDHS does not contract with individuals directly, but with business entities who furnish contract and temporary workers as needed.

TDHS does not provide incentives for state employees to return as contract workers. The incentives appear to be primarily in the form of increased compensation as an employee of a contracting firm caused by a short supply of IT workers in relation to demand. Since state salaries for IT workers have not increased to keep pace with the market, there is actually an incentive to leave state employment for the private sector.

The table in Appendix 2 on page 26 of the report shows \$63.2 million of expenditures for FY98 as recorded by USAS. It should be noted that the information furnished to the House Appropriations Subcommittee showed that \$24.3 million of the reported expenditures was for contract and temporary workers and consultants. The remainder was contract expenditures for services or products; for example \$16.2 million for EBT services provided by Transactive Corporation, numerous janitorial service contracts, and computer equipment maintenance and repair.

Concluding Remarks

TDHS will be please to answer any questions or provide additional information you may need as a result of this response.

Parks and Wildlife Department

Thank you for the opportunity to review the draft report on the State's Contract Workforce. The TPW recognizes the need for improvements in the reporting, control, and analysis of data related to contracted services. The agency also understands that better management controls are necessary. The concerns surrounding contracted services provide an excellent example of the challenges agencies face in attempting to find a reasonable balance between increased demands for agency services and the resultant demands on agency resources. It is increasingly necessary to try to do more with less. The pressure for better management information and control often occurs simultaneously with pressure to decrease the number of central administrative personnel that are best able to design and monitor these systems.

A critical part of finding a balance between these conflicting demands is a consistent approach to monitoring contractor services. It has been difficult to justify the expenditure of resources necessary to accurately and uniformly document and track the provision of contract services when the required measures already require significant time commitment. With a uniform philosophy and approach to measurement that meets the needs of the Governor, the Legislature and the relevant oversight agencies, it would be much easier for agencies to design a meaningful system of management controls. It is hoped that this audit report is a step in that direction. In the meantime, TPW managers will be exploring ways to provide more accurate and meaningful data leading to more efficient and effective use of state resources through improved agency management and oversight of contract services.

Agency management would like to respond to one point in the draft report.

- **Violations of the Article IX provisions on contracts with former employees**

As noted in the report, TPW did mistakenly place some former employees on contract status within 12 months of their last period of employment, contrary to the prohibition in Article IX. All of these were contract providers for a "Learn to Swim" instruction program at the Bastrop State Park swimming pool. Each of the five instructors with contracts had worked the previous summer as temporary state employees assigned as lifeguards at the pool. These employees were paid from funds donated by the local Lions Club to fund this educational program. The park manager was not aware that these funds were considered appropriated funds and subject to the Article IX provision. Each was selected based on their responses to a newspaper add for summer work at the pool.

In summary, the TPW supports the needs for better collection and reporting of contract data. This audit report is an important step in a process that will, hopefully, led to better definition of the data needed, specific areas of concern and guidance on acceptable uses of contract and other contingency workers. This audit and the current Legislative review of this issue will hopefully lead to revised reporting and tracking methods. If the management control systems that are established do not have a significant effect on the cost benefits that can potentially come through contracted services, everyone will be ahead. Thank you again for the opportunity to respond to the draft report.

Workforce Commission

Thank you for giving us the opportunity to respond to your Audit Report on the State's Contract Workforce.

We appreciate you recognizing that the Texas Workforce Commission analyzed the costs and benefits of using contract workers to perform seasonal work; thereby saving approximately \$286,000 annually. It should also be noted that TWC's Information Technology (IT) Department performs an extensive cost benefit analysis to determine the feasibility of using employees versus contract workers. Approximately 95% of the IT contract workers at this agency are for special projects. These projects, by their very nature, are generally short term with urgent deadlines.

We agree with the recommendations made in your audit report. We will implement the recommendations that TWC does not already have in place. Also, we support modifying the USAS reporting requirements to reduce the number of object codes for contract worker expenditures. The recommended coordination between the Comptroller's Office and the Legislative Budget Board would eliminate duplication of effort on the part of agencies.

Once again, we appreciate the cooperative working relationship that we continue to enjoy with you and your staff.

Objectives, Scope, and Methodology

Objectives

The primary objectives of this project were to:

- Review agency use of long-term contract and temporary workers and determine the agencies':
 - Reasons for using a contract workforce
 - Decision-making processes used when hiring contract versus state workers
 - Levels of management exercised with contract workforce
- Determine how to improve collection and reporting of contract workforce information to the Legislature.
- Provide agencies with information on what considerations they should take into account when creating a contract workforce.

Scope

The scope of this audit included management activities related to the contract workforces of five state agencies. The agencies selected were in the top 20 in terms of contract worker expenditures. Also, information collected indicates that these agencies had numerous long-term contract and temporary employees. We focused on long-term contract and temporary workers who work alongside state employees. The agencies selected for review included:

- Office of the Attorney General
- Comptroller of Public Accounts
- Department of Human Services
- Parks and Wildlife Department
- Workforce Commission

Additionally, our Office researched the use and management of contract workers. Along with this report, we developed a guide containing best practices and guidelines for using a contract workforce. The guide is scheduled for release in March 1999.

Methodology

The methodology used for this audit consisted of collecting information performing audit tests and procedures, and analyzing and evaluating the results against established criteria.

Information collected:

- Interviews with the management of all five agencies audited
- Documentary evidence such as:
 - Policies and procedures related to contract workers
 - Applicable state statutes and guidelines
 - Contracts
 - Internal agency reports/studies
- Contract workforce literature including:
 - Management of the contract workforce
 - Related legal issues
 - Contract workforce development

Procedures and tests conducted:

- Cost analyses comparing contract workers to state employees
- Review of Legislative Appropriations Requests, FTE reports, and turnover statistics
- Analysis of USAS and USPS data
- Trend analysis of expenditures according to select object codes
- Review of policies and procedures and other documents provided by agencies
- Review of documentation relating to agency decisions on developing and managing their contract workforce
- Review of USAS object codes and Legislative Budget Board database information
- Review and analysis of contract workforce literature
- Other procedures as deemed necessary

Criteria used:

Various criteria from research conducted and the State Auditor's Office Methodology on management practices were used.

Other Information

Fieldwork was conducted from October to December 1998. The audit was conducted in accordance with applicable professional standards and generally accepted governmental auditing standards.

The following members of the State Auditor's staff performed the audit work:

- Andrea Claire, JD, MBA, Project Manager
- William D. Hastings, CPA, Assistant Project Manager
- Thomas Brannon, CPA
- Amy Dinger, MPAff
- Verma L. Elliott, MBA
- Ann Huebner, CGFM
- Michael C. O'Connor, CPA
- Jeanine Pollard, CCP, MS
- Susan C. Van Hoozer, MBA
- Dennis O'Neal, CIA, Quality Control Reviewer
- Kelli Dan, PHR, CCP, Audit Manager
- Craig Kinton, CPA, Audit Director

Contract Workforce Expenditures for Audited Agencies

How Much Did Audited Agencies Spend?

Amounts in Table 5 represent audited agencies' contract worker-related expenditures as recorded by the Uniform Statewide Accounting System (USAS). Table 5 also shows the percentage of increased cost for contract workers between fiscal years 1995 and 1998 at each agency audited.

Table 5

Contract Workforce Expenditures by Agency (in Millions) ^a					
Agency	Fiscal Year 1995	Fiscal Year 1996	Fiscal Year 1997	Fiscal Year 1998	Percent Increase
Office of the Attorney General	\$ 14.6	\$ 9.2	\$ 15.1	\$ 19.9	36%
Comptroller of Public Accounts	\$ 19.9	\$ 21.7	\$ 29.4	\$ 31.5	58%
Department of Human Services	\$ 39.2	\$ 55.4	\$ 54.3	\$ 63.2	61%
Parks and Wildlife Department	\$ 5.7	\$ 6.9	\$ 7.4	\$ 11.2	96%
Workforce Commission ^b	—	—	\$ 13.0	\$ 18.8	45%

^aAgency dollar amounts represent net expenditures for selected object codes as recorded by the Uniform Statewide Accounting System (USAS) for fiscal years 1995 through 1998. The State Auditor's Office selected the 25 expenditure categories that appeared most inclusive of consultants and contractors. In some cases, dollar expenditures may not be recorded in the correct USAS object code due to the complexities of the USAS codes for contract workers and a lack of consistent reporting by agencies. Therefore, these dollar figures may be either overstated or understated.

^bThere is no meaningful comparative data for fiscal years 1995 and 1996 because the Workforce Commission was formed by consolidating the Texas Employment Commission and programs from several other agencies including the Department of Human Services.

Source: Uniform Statewide Accounting System

Contract worker costs increased between fiscal years 1995 and 1998 for all agencies audited. The most significant increase occurred at the Department of Human Services where costs increased from \$39.2 million to \$63.2 million or 61 percent. The Attorney General and Comptroller had significant dollar expenditures for contract workers in all four years. The Parks and Wildlife Department almost doubled the amount spent on contract workers between fiscal years 1995 and 1998. The Workforce Commission's dollar expenditures increased almost 45 percent between fiscal years 1997 and 1998.

Where Did the Money Come From to Hire Contract Workers?

Legislative appropriation requests did not contain specific line items for contract workers. Instead, the five agencies reviewed funded their contract workforces using a number of common and agency specific appropriations funding strategies. For examples of funding strategies used, see Table 6.

Table 6

Funds Used for Contract Workforces	
Audited Agencies Combined	
Information Resources.....	\$23.5 million
Year 2000 Conversion	\$10.0 million
Central Administration	\$3.4 million
Office of the Attorney General	
Child Support Enforcement	\$16.7 million
Comptroller of Public Accounts	
Uniform Statewide Accounting System	\$8.1 million
Revenue Processing	\$4.1 million
Department of Human Services	
Client Self Support Eligibility	\$23.3 million
Agency/Interagency Cost Pool.....	\$6.5 million
Nursing Facility Payments.....	\$5.9 million
Parks and Wildlife Department	
Law Enforcement	\$2.3 million
RD-23 Fee Revenue.....	\$2.6 million
Workforce Commission	
Unemployment Insurance.....	\$5.4 million
Provide Local Workforce Services.....	\$7.5 million

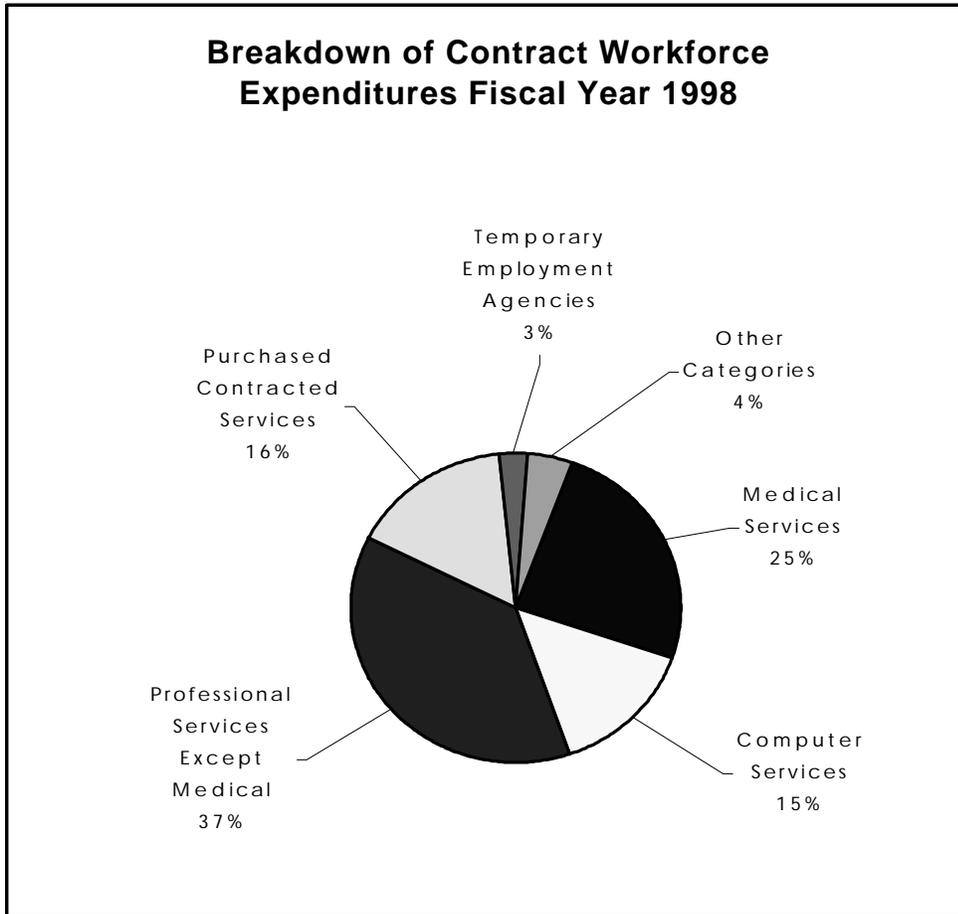
Source: Uniform Statewide Accounting System

Appendix 3:

Breakdown of Contract Workforce Expenditures

Figure 3 identifies major categories of statewide contract workforce expenditures for fiscal year 1998 totaling \$1.2 billion.⁵

Figure 3



Source: Uniform Statewide Accounting System

⁵Total includes \$67.7 million in interagency contracts, which represents 6 percent of the statewide total of \$1.2 billion.