

# **An Audit of Professional Service Contracting**

**December 2008**

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Department of Audit

# Milwaukee County

Jerome J. Heer

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December 18, 2008

To the Honorable Chairman  
of the Board of Supervisors  
of the County of Milwaukee

We have completed an audit of Professional Service Contracting by Milwaukee County departments in accordance with County Board Resolution [File No. 07-79].

The report notes that there is considerable similarity between the definitions of a professional service in s. 56.30 and negotiated contractual services described in s. 32.36 and 32.37 of the Ordinances. Additional clarity is needed in the definition of professional services to help ensure consistent interpretation by all County administrators.

A response from the Department of Administrative Services is included as Exhibit 2. We appreciate the cooperation extended by administrators and staff throughout Milwaukee County government during the course of this Countywide audit.

Please refer this report to the Committees on Finance and Audit.

Jerome J. Heer  
Director of Audits

JJH/cah

Attachment

cc: Milwaukee County Board of Supervisors  
Scott Walker, Milwaukee County Executive  
Cynthia Archer, Director, Department of Administrative Services  
Terrance Cooley, Chief of Staff, County Board Staff  
Steven Kreklow, Fiscal & Budget Director, DAS  
Steve Cady, Fiscal & Budget Analyst, County Board Staff  
Delores Hervey, Chief Committee Clerk, County Board Staff

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# An Audit of Professional Service Contracting

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## Summary

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Section 56.30 of the Milwaukee County Ordinances was created in 1984 to provide department administrators with guidance when entering into professional service contracts. Prior to 1984, professional service contracts were specifically excluded from having to follow the standard purchasing rules set forth in Chapter 32 of the Milwaukee County Ordinances. As a result, administrators could use their discretion when obtaining professional services.

Today, s. 56.30, along with s. 1.13 of the Administrative Manual, provide County departments with detailed instructions on what to do when entering into professional service contracts. Some of the major issues addressed by both authoritative sources include:

- Defining what constitutes a professional service subject to s. 56.30.
- Establishing dollar thresholds at which County Board approval is required before entering into the contract.
- Establishing dollar thresholds at which point administrators need to solicit competitive proposals by following a request for proposal (RFP) process.
- Establishing rules for soliciting proposals, as well as identifying exceptions when rules can be by-passed.
- Establishing roles that other departments play in the contracting process, such as Corporation Counsel, Risk Management, Community Business Development Partners (CBDP), and the Controller for the Department of Administrative Services (DAS).

In 2007, Milwaukee County awarded 432 professional service contracts totaling \$48.7 million.

### **Importance of Clarity in Professional Service Definition**

The importance of maintaining a clear definition of professional services that is consistently interpreted by all County administrators was demonstrated in a 2004 contract award for cellular telephone services. At that time, an RFP was issued by the Information Management Services Division (IMSD) of the Department of Administration, following the protocols established for professional service contracts under s. 56.30 of the Ordinances. After assembling an evaluation panel and reviewing proposals submitted by three different firms, IMSD sought County Board approval to award a contract to the firm recommended by the panel.

One of the firms that was not recommended by the panel, and which contained the lowest cost proposal, challenged the contract award. Part of the challenge questioned the basis for awarding

the contract as a professional service under s. 56.30 of the Ordinances, as opposed to a contractual service under s. 32.25.

A compromise whereby each of the three proposing firms received a portion of the County's cell phone business was eventually reached, avoiding potentially costly litigation.

There is considerable similarity between the definitions of a professional service in s. 56.30 and a negotiated contractual service described in s. 32.36 and 32.37 of the Ordinances. The concept of awarding a contract based on criteria other than price alone is prominent under both types of contracts. Thus, this same concept could be cited by administrators for choosing to award a particular contract under either Ordinance provision. We selected 63 contracts for review from the quarterly reports of all professional service contracting prepared by the Controller from information provided to him by County departments. Based on the definition provided in s. 56.30 and the specific examples contained in the Administrative Manual, as well as the definition of a negotiated contract under s. 32.36 of the Ordinances, the following contracts indicate a need for clarity and enhanced guidance for administrators in determining the appropriate use of professional service contracting.

- A contract to furnish and operate an air tram system at the Zoo was awarded as a professional service agreement. The five-year contract, with an option for a second five-year term, calls for the vendor to retain 75% of gross receipts generated by the ride. Based on a contract provision allowing the vendor to terminate the agreement if annual gross receipts fall below \$350,000, the contract is expected to generate at least \$1.3 million in revenue for the vendor. This contract appears to be a viable candidate for award through the Procurement Division under the negotiated contract provisions of s. 32.36 of the Ordinances.
- A licensing agreement to operate a golf reservation system, initially awarded as a professional service contract by the Parks Department in 1993 and extended in three-year increments through 2005. The contract extension reviewed for the period 2003 through 2005 resulted in vendor payments of approximately \$299,000. In 2006, a one-year extension was granted for \$95,000. Licensing agreements are specifically identified in s. 1.13 of the Administrative Manual as an item that is not appropriate for a professional service contract. In 2007, another RFP was issued for this product. A Parks administrator initially thought the 2007 contract was awarded with the assistance of the Procurement Division under s. 32.36 of the Ordinances, but further review indicates it was again awarded as a professional service contract. This particular example illustrates perfectly the 'overlap' between contract award provisions under s. 56.30 and s. 32.36 of the Ordinances, and why clarity is needed to guide County administrators in following the appropriate course of action.
- A contract by the Zoo to operate a minimum of four foot massage machines. The contract was initially for \$10,000 in 2004, with increases of \$6,622, and \$1,000 in 2005 and 2006, respectively. Although the Zoo Director told us the Procurement Division indicated this contract should be awarded as a professional service, one could easily justify this as a procurement under Chapter 32 of the Ordinances.

## **Resources for Defining Professional Services**

Section 56.30 and s. 1.13 of the Administrative Manual provide guidance as to what types of services are, and are not, professional services. Two other resources are identified in these documents as available to help administrators determine if a needed service meets the definition of a professional service.

The first is Corporation Counsel, who is required by s. 56.30 to review all professional service contracts to determine if they meet the appropriate definition. However, according to Corporation Counsel, department administrators rarely ask for assistance when deciding what type of service is being contracted.

The second resource, identified in Administrative Manual s. 1.13, is the Purchasing Standardization Committee, established by s. 32.23 of the Ordinances. The Committee's basic function is to review supplies, materials and equipment commonly used for adoption of appropriate standards by all departments. It can also adopt, revise and promulgate written standards that satisfy the requirements of the County. Although s. 1.13 of the Administrative Manual indicates the Purchasing Standardization Committee is charged with the responsibility of determining if a service meets the definition of a professional service, such responsibility is not specifically noted anywhere in the Ordinances. It is not clear from what authority this language in s. 1.13 is derived.

Further, the Purchasing Standardization Committee has not met regularly for several years. This non-use raises the issue of whether the committee, as currently constructed, serves the meaningful purpose indicated from its description in s. 32.23 of the Ordinances.

## **Evaluating the Cost-Effectiveness of Professional Service Contracting**

Once it is determined that a needed service falls within the purview of professional services, the process of soliciting and selecting a contractor is well established in the Ordinances, as well as the Administrative Manual. However, the guidance provided in both the Ordinances and the Administrative Manual presumes the decision to acquire desired services through a contractual agreement with an outside party has already been made. Our review of files documenting the contract award process for 63 professional services contracts, as well as interviews with departmental administrators, indicate there is little formal evaluation of the cost-effectiveness of obtaining professional services through outside contracts, as opposed to in-house professional positions.

## Cost Comparison Factors

Borrowing from a State of Wisconsin model, we identified several factors administrators should consider when conducting a high-level cost comparison to determine the cost-effectiveness of using professional service contracts versus adding or deploying existing in-house county positions and resources.

However, certain complexities of Milwaukee County's accounting and budgeting environment must be understood and recognized when undertaking a comparison of the relative cost-effectiveness of outside contracted services, as opposed to using in-house staff. The concepts of fixed and variable costs are essential underpinnings in any cost-benefit analysis. In considering a financial decision, fixed costs are those expenditures that will not change, regardless of the decision made. This notion is particularly important with respect to Milwaukee County's fringe benefit costs. As will be discussed in detail below, a significant portion of County fringe benefit costs are associated with retired former employees. These so-called 'legacy' costs are property rights of those individuals and their beneficiaries under Wisconsin law, and as such Milwaukee County is obligated to pay those costs without regard to the number of current employees that are added or subtracted from its workforce. As a result, even though Milwaukee County budgets for legacy costs on a per-employee basis, the elimination of a budgeted position will **not** eliminate the budgeted legacy costs associated with that position. In other words, legacy costs are *fixed costs*.

Key internal cost factors needed for comparisons to outside contract costs include:

- Wage rates for comparable in-house positions;
- Adjustments for paid leave and fringe benefits, if applicable;
- Space and utility costs, if additional expense would be incurred, or if the service is performed long-term, a proportionate share of such costs;
- Equipment and furnishings, if additional expense would be incurred, or if the service is performed long-term, a proportionate share of such costs;
- Transportation costs, if applicable; and
- Other miscellaneous costs, if applicable.

Whether or not a specific cost factor should be included or adjusted may depend upon the nature of the professional service contract being considered. Cost is not, and should not, be the sole determining factor when a County administrator chooses between requesting additional in-house resources, or utilizing outside resources through utilization of professional service contracting. In

some instances, such as addressing a short-term need for a specific expertise, or if obtaining objective, outside expertise is of paramount concern, it may not be practical or desirable to consider in-house staff, and a formal cost-benefit analysis may not be appropriate. In other instances, where additional workload is anticipated on a permanent basis, cost should be an important consideration, and some type of documentation of the factors considered, including cost and other factors, should be documented in the file.

### **Compliance with Professional Service Contracting Requirements**

County administrators need to comply with numerous other requirements as they enter into a contract. Depending on specific circumstances as outlined in the Ordinances and Administrative Manual, such requirements may include, but are not limited to:

- Ensuring there are there sufficient funds in the department's budget to pay for the service.
- Obtaining County Board approval.
- Issuing an RFP to solicit competitive proposals from a number of potential vendors.
- Obtaining all the required contractual clauses and approvals by those required to review the contract.

In addition, s. 56.30 of the Ordinances lists the rules and exceptions which guide departmental contract administrators when soliciting competitive proposals for services using the request for proposal (RFP) process. The basic requirements are:

- Contracts of less than \$20,000 do not require the use of an RFP, though the selection process must be documented and maintained for seven years after completion.
- For contracts of \$20,000 to \$99,999, an RFP must be used unless the department administrator determines it would not be cost effective to solicit proposals. Such action must be reported, in writing, with an explanation as to the benefits derived from not seeking proposals, to the County Board when the contract is submitted for approval.
- Use of an RFP is required unless waived by County Board Resolution for contracts over \$100,000.

Our review of a sample of 63 professional service contracts found generally good compliance with these requirements. Exceptions are noted in the report. Compliance could be enhanced with a revision to s. 56.30 of the Ordinances that instructs administrators to use s. 1.13 of the Administrative Manual for guidance in meeting all professional service contracting requirements.

### **Other Professional Service Contracting Issues**

Contract administrators currently have no single location that identifies all the requirements related to professional service contracting. An up-to-date Administrative Manual arguably comes closest to encapsulating all requirements. It provides valuable procedural guidance for County managers and staff to follow for ensuring County Board requirements are met in all aspects of day-to-day operations in addition to professional service contracting, but it has limitations. For instance, we identified inconsistencies between the governing Ordinance and the subordinate Administrative Manual that require corrective action.

Over the past few years, significant improvements have been made to the County's intranet web site to provide management and staff the ability to electronically access various forms and financial information. However, the Administrative Manual has not been brought on-line in this fashion. Although DAS placed s. 1.13 of the Administrative Manual in the Forms Library of Lotus Notes this past summer, it has not prominently publicized this placement. A comprehensive, up-to-date, electronically accessible Administrative Manual can help all users, including contract administrators, better perform their jobs.

### **Encumbering Professional Service Contracts**

The encumbrance process (reserving appropriated funds for committed contractual obligations) serves as an important internal control to prevent departments from spending budgeted funds that have been committed for other purposes. In the case of professional service contracting, departments could potentially commit the County to contracts for which funds may not be available when payment is requested if they are not first encumbered. However, this control can be circumvented in cases when a department does not submit appropriate paperwork to DAS, and when payments for that contract are not made via the normal check request process through DAS. This can occur when payments to contractors are made in the form of electronic fund transfers (EFT). The safeguards provided by a properly functioning encumbrance process need to be extended to all EFT payments in which funds are not first encumbered.

We provide recommendations to address each of the problems identified in this audit report. A management response from the Department of Administrative Services is included as **Exhibit 2**. We wish to acknowledge the cooperation of administrators and staff throughout Milwaukee County government during the course of this Countywide audit.

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## Background

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County Board Resolution [File No. 07-79] called for the Director of Audits to conduct an audit of procedures related to the execution of professional service contracts by Milwaukee County departments. Section 56.30 of the Milwaukee County Ordinances (see **Exhibit 3**) was created in 1984 to provide department administrators with guidance when entering into professional service contracts. Prior to 1984, professional service contracts were specifically excluded from having to follow the standard purchasing rules set forth in Chapter 32 of the Milwaukee County Ordinances. As a result, administrators could use their discretion when obtaining professional services.

Today, s. 56.30, along with s. 1.13 of the Administrative Manual, provide County departments with detailed instructions on what to do when entering into professional service contracts. Some of the major issues addressed by both authoritative sources include:

- Defining what constitutes a professional service subject to s. 56.30.
- Establishing dollar thresholds at which County Board approval is required before entering into the contract.
- Establishing dollar thresholds at which point administrators need to solicit competitive proposals by following a request for proposal (RFP) process.
- Establishing rules for soliciting proposals, as well as identifying exceptions when rules can be by-passed.
- Establishing roles that other departments play in the contracting process, such as Corporation Counsel, Risk Management, Community Business Development Partners (CBDP), and the Controller for the Department of Administrative Services (DAS).

In addition to defining what constitutes a professional service, the Ordinances and accompanying Administrative Manual break professional services into two classifications. The first classification consists of contracts related to capital improvements, examples of which include services provided by engineers. The second category includes all other contracts, referred to as non-construction related professional service contracts. The contracting requirements are essentially identical except for some different dollar thresholds relating to when the RFP process needs to be used, and some different rules relating to when County Board approval is required.

Departments are required to provide the Controller with specified information related to each professional service contract. The Controller summarizes this information in a quarterly report that is issued to the County Board. The Controller's quarterly report includes contracts that cover

multiple years. In such cases, the quarterly reports include both the amount of the current contract award, along with the sum total of all earlier years of the contract (an amount that also includes the current year contract award). From an informational standpoint, the larger amount can give insights as to magnitude of the contract when reviewing the report on a contract-by-contract basis. **Table 1** summarizes the current year contract value from these reports to show the extent of professional service contracting from 2004–2007, broken out by the number and associated contract value for both construction and non-construction contracts.

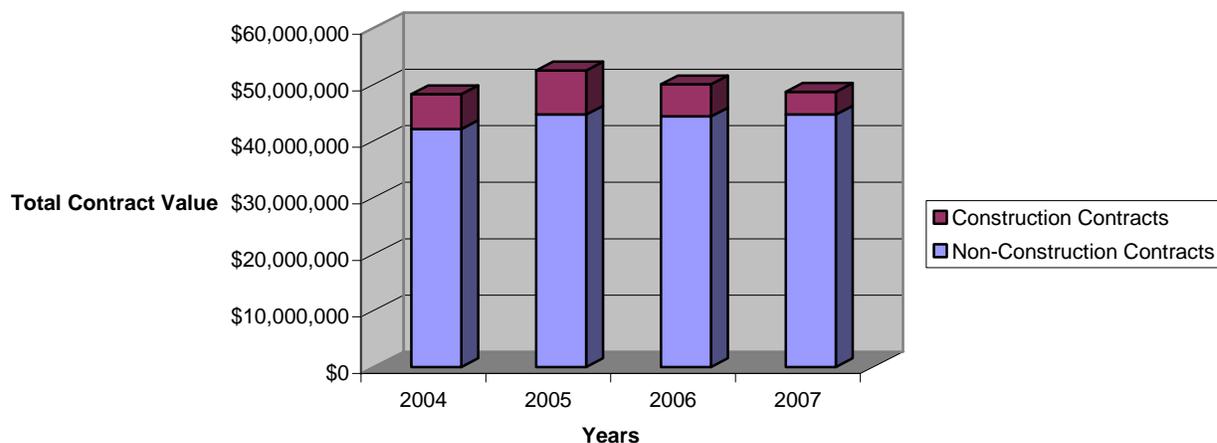
**Table 1**  
**Summary of Annual Professional Service Contract Awards**  
**2004 – 2007**

	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>
<b>Non-Construction Contracts:</b>				
Total No. of Contracts	370	339	356	373
New Contracts & Extensions	\$42,104,752	\$44,658,822	\$44,338,443	\$44,672,313
<b>Construction-Related Contracts:</b>				
Total No. of Contracts	63	72	49	59
New Contracts & Extensions	\$6,155,178	\$7,797,658	\$5,647,346	\$4,006,264
<b>Total of All Contracts:</b>				
Total No. of Contracts	433	411	405	432
New Contracts & Extensions	\$48,259,930	\$52,456,480	\$49,985,789	\$48,678,577

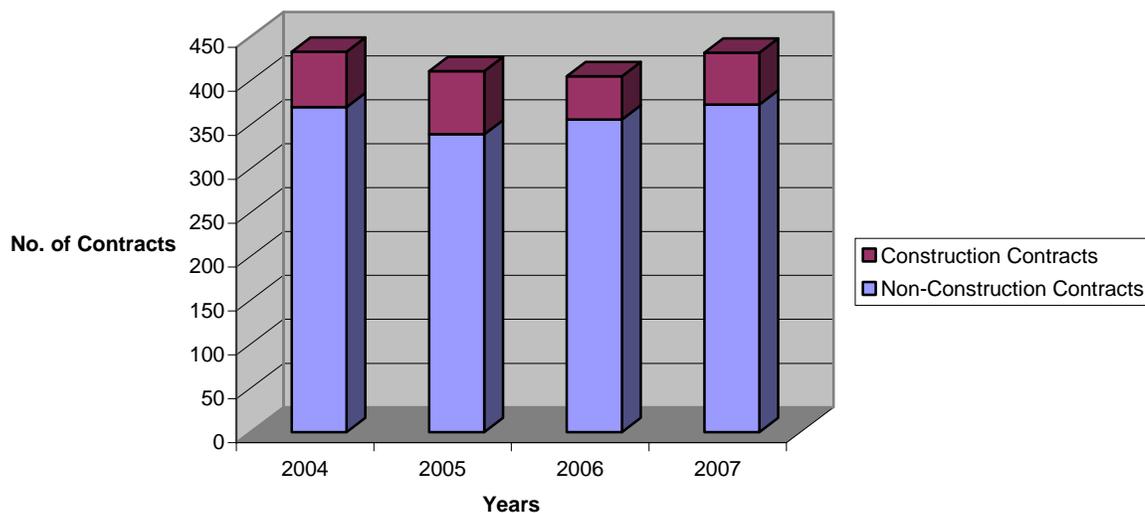
Source: Current year contract values extracted from quarterly reports prepared by DAS for 2004 – 2007.

The following charts help to depict the same information in graphic form to show the extent to which non-construction professional service contracts exceeded their counterparts, both in dollars and numbers of contracts.

**Figure 1**  
**Value of All Professional Services**  
**2004 - 2007**



**Figure 2**  
**Number of Professional Services Contracts**  
**2004 - 2007**



As these charts show, the amount of non-construction professional service contracting greatly exceeds construction-related contracting, both in contract value and the number of contracts. Also, past reviews have shown few problems with construction related professional service contracting. The Department of Transportation and Public Works, which oversees these contracts, has

consistently reached participation goals established by the County Board for Disadvantaged Business Enterprise (DBE) firms, one of several contracting requirements that are discussed in the Audit Results Section of this report. As a result, this report focused attention on non-construction related professional service contracting.

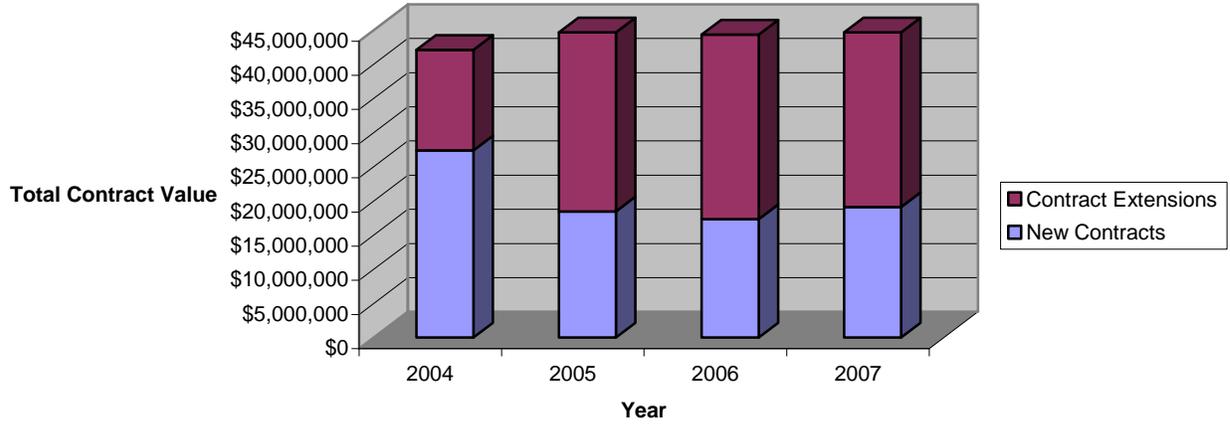
**New Contracts vs. Extensions of Existing Contracts**

**Table 2** further breaks out the information on non-construction professional service contracts into new contracts and extensions of existing contracts.

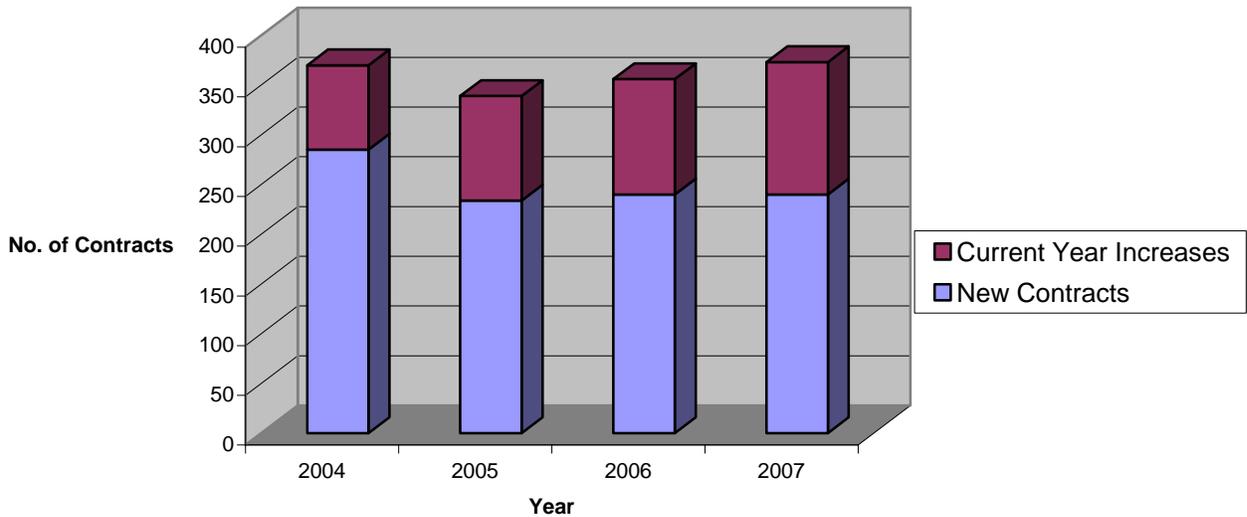
<b>Table 2</b>				
<b>Summary of New Contracts vs. Contract Extensions</b>				
<b>For Non-Construction Professional Service Contracts</b>				
<b>2004 – 2007</b>				
	<u><b>2004</b></u>	<u><b>2005</b></u>	<u><b>2006</b></u>	<u><b>2007</b></u>
<b>New Contracts:</b>				
Total No. of New Contracts	285	234	240	240
Value of New Contracts	\$27,394,316	\$18,479,847	\$17,330,401	19,109,038
<b>Contract Extensions:</b>				
Total No. of Contract Extensions	85	105	116	133
Value of Contract Extensions	\$14,710,436	\$26,178,975	\$27,008,041	25,563,275
<b>Total of All Non-Construction Contracts:</b>				
Total No. of Contracts	370	339	356	373
Value of New and Contract Extensions	\$42,104,752	\$44,658,822	\$44,338,442	44,672,313
Source: Current year contract values extracted from quarterly reports prepared by DAS Controller or 2004 – 2007.				

The following two charts help to depict the same information graphically to show the relationship of new contracting versus additions to existing contracts Countywide.

**Figure 3**  
**Value of Non-Construction Professional Services Contracting**  
**New Contracts vs. Contract Extensions**  
**2004 - 2007**



**Figure 4**  
**Number of Non-Construction Professional Services Contracts**  
**New Contracts vs. Contract Extensions**  
**2004 - 2007**



These charts help highlight the fact that the number of new contracts exceeds contract extensions, but that the total value of contract extensions over the last three years has been greater than that of new contracts.

During discussion of the resolution directing initiation of this audit at the January 2007 Finance and Audit Committee, a review of Disadvantaged Business Enterprise (DBE) participation in professional service contracts was requested. Due to a lack of organizational independence\* from the Office of Community Business Development Partners, which oversees DBE participation in professional service contracts, we did not include the results of that portion of our review in this audit report so as to remain in compliance with Generally Accepted Government Auditing Standards. However, we believe our analysis of issues related to that request has value, and have communicated our findings to the Chairman of the County Board. The Chairman has initiated action to address those issues. This audit focuses on non-construction related professional services, as this has been an area of concern in prior audits.

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\* Both the Director of Audits and the Director of the Office of Community Business Development Partners reports directly to the Chairman of the Milwaukee County Board of Supervisors.

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## Section 1: Defining Appropriate Use of Professional Service Contracting

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Section 56.30 of the Milwaukee County Ordinances details the requirements that operating departments must follow when entering into non-construction professional service contracts. Additional requirements and contracting guidance are contained in the County's Administrative Manual, s. 1.13, which includes a checklist to help department administrators make sure they follow all contracting requirements.

**Section 56.30 of the Ordinances defines what constitutes a professional service.**

### **Ordinance Definition of Professional Services**

The first question on this checklist asks whether or not the service meets the definition of a professional service. Section 56.30 defines what constitutes a professional service, and thus falls under the requirements of that Ordinance. It states that:

“Professional service means services, the value of which is substantially measured by the professional competence of the person performing them and which are not susceptible to realistic competition by cost of services alone. The services provided must be materially enhanced by the specific expertise, abilities, qualifications and experience of the person that will provide the service. Professional services shall typically include services customarily rendered by architects; engineers; surveyors; real estate appraisers; certified public accountants; attorneys; financial personnel; medical services, except when such services are delivered to clients of the general assistance-medical program or to county employees as part of a workers compensation claim and social services; system planning; management and other consultants; and services for promotional programs.”

The Administrative Manual goes further in defining professional services. Section 1.13 states that the use of professional services via s. 56.30 contracting versus Chapter 32 procurement is only allowed when a highly technical or highly specialized skill is required. It lists the following examples of services that **do not meet** the definition of a professional service:

- Guard and security services.
- Advertising, including placements within all types of media (radio, television, newspapers and magazines).
- Service maintenance agreements.
- Repairs to equipment.
- Leasing or long-term temporary help employment.
- Temporary clerical help.
- Software licenses and maintenance agreements.
- Rental or lease of office or parking space.

### **Contracts Indicating Need for Clarity and Enhanced Guidance for Administrators**

County departments enter into a wide variety of contracts that call for services to be rendered. Despite these specific guidelines, County administrators are challenged in many instances with procuring services that may not fall neatly into the category of a **contractual** service, one that is procured by the Procurement Division following the requirements of Chapter 32 of the Ordinances, or a **professional** service, one that is procured by department administrators following the requirements of s. 56.30. Indeed, there is considerable similarity between the definitions of a professional service in s. 56.30 (see previous page) and a negotiated contractual service described in s. 32.36 and s. 32.37 of the Ordinances:

**There is considerable similarity between the definitions of a professional service in s. 56.30 and a negotiated contractual service described in s. 32.36 and s. 32.37 of the Ordinances.**

“32.36. Negotiations and competitive proposals. This section covers general requirements regarding negotiated contracts. Detailed and specific requirements appear throughout this section.

32.37. General. Negotiation is a procedure that includes the receipt of proposals from offerors, permits bargaining, and usually affords an opportunity to revise their offers before award of a contract. Bargaining, in the sense of discussion, persuasion, alteration of initial assumptions and positions, and give-and-take, may apply to price, schedule, technical requirements, type of contract, or other terms of a proposed contract. Negotiations are appropriate if one (1) or all of the following conditions exist:

- (1) Adequate specifications are not available or would be too expensive to develop.
- (2) Discussions with the offerors are required.

- (3) Evaluation and award factors include criterion other than price or price related factors.
- (4) Other than a firm fixed price contract is to be awarded.”

The concept of awarding a contract based on criteria other than price alone is prominent under both types of contracts. Thus, this same concept could be cited by administrators for choosing to award a particular contract under either Ordinance provision.

We selected 63 contracts for review from the quarterly reports prepared by the Controller from information provided by County departments. They were chosen from the quarterly reports that the Controller issued to the Finance and Audit Committee as required by s. 56.30 of the Ordinances. Based on the definition provided in s. 56.30 and the specific examples contained in the Administrative Manual, as well as the definition of a negotiated contract under s. 32.36 of the Ordinances, the following contracts indicate a need for clarity and enhanced guidance for administrators in determining the appropriate use of professional service contracting.

**These contracts indicate a need for clarity and enhanced guidance for administrators in determining the appropriate use of professional service contracting.**

- A contract to furnish and operate an air tram system at the Zoo was awarded as a professional service agreement. The five-year contract, with an option for a second five-year term, calls for the vendor to retain 75% of gross receipts generated by the ride. Based on a contract provision allowing the vendor to terminate the agreement if annual gross receipts fall below \$350,000, the contract is expected to generate at least \$1.3 million in revenue for the vendor. This contract appears to be a viable candidate for award through the Procurement Division under the negotiated contract provisions of s. 32.36 of the Ordinances.
- A licensing agreement to operate a golf reservation system, initially awarded as a professional service contract by the Parks Department in 1993 and extended in three-year increments through 2005. The contract extension reviewed for the period 2003 through 2005 resulted in vendor payments of approximately \$299,000. In 2006, a one-year extension was granted for \$95,000. Licensing agreements are specifically identified in s. 1.13 of the Administrative Manual as an item that is not appropriate for a professional service contract. In 2007, another RFP was issued for this product. A Parks administrator initially thought the 2007

contract was awarded with the assistance of the Procurement Division under s. 32.36 of the Ordinances, but further review indicates it was again awarded as a professional service contract. This particular example illustrates perfectly the 'overlap' between contract award provisions under s. 56.30 and s. 32.36 of the Ordinances, and why clarity is needed to guide County administrators in following the appropriate course of action.

- A contract by the Zoo to operate a minimum of four foot massage machines. The contract was initially for \$10,000 in 2004, with increases of \$6,622, and \$1,000 in 2005 and 2006, respectively. Although the Zoo Director told us the Procurement Division indicated this contract should be awarded as a professional service, one could easily justify this as a procurement under Chapter 32 of the Ordinances.

### **Importance of Clarity in Professional Service Definition**

**The importance of maintaining a clear definition of professional services was demonstrated in a 2004 contract award for cellular telephone services.**

The importance of maintaining a clear definition of professional services that is consistently interpreted by all County administrators was demonstrated in a 2004 contract award for cellular telephone services. At that time, an RFP was issued by the Information Management Services Division of the Department of Administration, following the protocols established for professional service contracts under s. 56.30 of the Ordinances. After assembling an evaluation panel and reviewing proposals submitted by three different firms, IMSD sought County Board approval to award a contract to the firm recommended by the panel.

One of the firms that was not recommended by the panel, and which contained the lowest cost proposal, challenged the contract award. Part of the challenge questioned the basis for awarding the contract as a professional service under s. 56.30, as opposed to a contractual service under s. 32.25.

A compromise whereby each of the three proposing firms received a portion of the County's cell phone business was eventually reached, avoiding potentially costly litigation.

The importance of adding clarity to the definition of professional services for purposes of distinguishing the appropriate use of the contract award procedures under either s. 56.30 or s. 32.36 of the Ordinances is well-documented in this audit report. Efforts to add this clarity should not be confused with, or compromised by, separate efforts of a workgroup established by County Board Resolution [File No. 07-488] to clarify and strengthen the County's commitment to achieve compliance with Minority and Women Business enterprise goals in County procurement, professional services, time and material, and public works contracting, which is addressed in Chapter 42 of the Ordinances.

### **Resources for Defining Professional Services**

Section 56.30 of the Ordinances and s. 1.13 of the Administrative Manual provide guidance as to what types of services are, and are not, professional services. Two other resources are identified in these documents as available to help administrators determine if a needed service meets the definition of a professional service.

**Corporation Counsel is required by s. 56.30 to review all professional service contracts to determine if they meet the appropriate definition.**

The first is Corporation Counsel, who is required by s. 56.30 to review all professional service contracts to determine if they meet the appropriate definition. However, according to Corporation Counsel, department administrators rarely ask for assistance when deciding what type of service is being contracted.

The second resource, identified in Administrative Manual s. 1.13, is the Purchasing Standardization Committee, established by s. 32.23 of the Ordinances. It consists of representatives of four County departments, including Corporation Counsel, and three private citizens. The Committee's basic function is to review supplies, materials and equipment commonly used for adoption of appropriate standards by all departments. It can also adopt, revise and promulgate written standards that satisfy the requirements of the County.

Although s. 1.13 of the Administrative Manual indicates the Purchasing Standardization Committee is charged with the responsibility of determining if a service meets the definition of a professional service, such responsibility is not specifically noted anywhere in the Ordinances. It is not clear from what authority this language in s. 1.13 is derived.

Further, the Purchasing Standardization Committee has not met regularly for several years. This non-use raises the issue of whether the committee, as currently constructed, serves the meaningful purpose indicated from its description in s. 32.23 of the Ordinances.

To provide additional clarity for administrators in following proper professional service contracting procedures, we recommend that DAS:

- 1. Coordinate a workgroup comprised of staff from the Office of Corporation Counsel, DAS and County Board Staff, to recommend, for County Board consideration, revisions clarifying and clearly distinguishing professional services governed by s. 56.30 from contractual services governed by s. 32.36 of the Ordinance.*
- 2. Remind department administrators of the availability of Corporation Counsel as a resource in determining if a desired service qualifies as a professional service, and revise Administrative Manual s. 1.13 to eliminate reference to the Purchasing Standardization Committee as such a resource.*
- 3. Evaluate the purpose, composition and performance of the Purchasing Standardization Committee in light of the responsibilities with which that committee has been charged under s. 32.23 of the Ordinances and recommend, for County Board consideration, appropriate revisions.*

### **Evaluating the Cost-Effectiveness of Professional Service Contracting**

We have identified the need to provide clear and consistent guidance for administrators to determine when the use of professional service contracts, as defined in s. 56.30 of the

**The process of soliciting and selecting a contractor is well-established in the Ordinances.**

Milwaukee County Ordinances, is appropriate. Once it is determined that a needed service falls within the purview of professional services, the process of soliciting and selecting a contractor is well-established in the Ordinances, as well as the Administrative Manual.

However, the guidance provided in both the Ordinances and the Administrative Manual presumes the decision to acquire desired services through a contractual agreement with an outside party has already been made. Our review of files documenting the contract award process for 63 professional services contracts, as well as interviews with departmental administrators, indicate there is little formal evaluation of the cost-effectiveness of obtaining professional services through outside contracts, as opposed to in-house professional positions.

**Purpose of Professional Service Contracting**

Professional service contracting, when done properly, can be a valuable management tool for achieving department goals in a cost-effective manner. Typical reasons Milwaukee County administrators use professional service contracts include:

- Obtaining technical proficiency for specific instances when existing staff does not have the required expertise;
- Securing additional short-term personnel for times when workloads periodically peak, thus maintaining core staffing levels at lower levels, commensurate with more typical workloads;
- Providing short-term relief when immediate workload needs cannot be addressed within typical hiring process timeframes; and
- Establishing a degree of independence from the department or County.

Each of the above reasons has been cited by administrators for years as justification for seeking outside assistance in meeting the operational and programmatic needs of Milwaukee County departments. Section 56.30(5)(a)(1) of the Ordinances requires

administrators to report to the County Board, in writing, with an explanation as to the benefits derived from not seeking proposals on contracts of at least \$20,000 but less than \$100,000 when it is determined the process would not be cost-effective.

**There is no requirement to justify or document the cost-effectiveness or other reasons for utilizing professional service contracts.**

However, there is no similar requirement to justify or document the cost-effectiveness or other reasons for utilizing professional service contracts. Interviews with administrators indicate that in recent years, as pressure mounts to sustain service levels with less staff, and as centrally imposed hiring freezes represent a key tool for addressing unanticipated budgetary deficits, professional service contracts are increasingly viewed as one of the few options available for managers to fulfill department missions. Given this reality, it is not surprising that we found little evidence that administrators conducted even a cursory analysis to determine the cost-effectiveness of using outside contacts for professional services, versus retaining or adding in-house staff positions. Although, through interviews, administrators could articulate reasons justifying the use of professional service contractors, documentation of those reasons in the contract file were often sparse or absent.

A quarterly report prepared by the Controller identifies professional service contracts throughout the County. That report is reviewed by the Finance and Audit Committee of the County Board of Supervisors. Questions from Supervisors in recent years have probed the costs of some contracts in relation to the cost of hiring internal expertise. Those questions have typically centered around the hourly charge for individuals under a professional services contract. However, there are many factors that should be considered in determining the cost-effectiveness of using professional service contracts in lieu of in-house staff positions. It is important to note that each of the cost factors and adjustments identified must be considered in the context of the particular circumstances present for each

**Such factors as the need for outside objectivity and uneven workflows, among others, may outweigh cost differentials in many circumstances.**

contracting decision. Whether or not a specific cost factor should be included or adjusted may depend upon the nature of the professional service contract being considered, as discussed below. Further, cost alone may not be the determining factor. Consideration of such factors as the need for outside objectivity, the longevity of the need, and uneven workflows, among others, may outweigh cost differentials in many circumstances.

Key internal cost factors needed for comparisons to outside contract costs include:

- Wage rates for comparable in-house positions;
- Adjustments for paid leave and fringe benefits, if applicable;
- Space and utility costs, if additional expense would be incurred, or if the service is performed long-term, a proportionate share of such costs;
- Equipment and furnishings, if additional expense would be incurred, or if the service is performed long-term, a proportionate share of such costs;
- Transportation costs, if applicable; and
- Other miscellaneous costs and intangibles, if applicable.

These factors are presented in detail as **Exhibit 5**.

### **Documenting Cost and Other Considerations**

Formal consideration of whether or not it is more cost-effective to secure services through professional service contracts or through the addition of in-house staff is not addressed in either the Milwaukee County Ordinances or the Administrative Manual. It is naturally presumed that administrators take into account the most cost-effective manner of obtaining and providing needed services.

As described earlier in this report section, cost is not, and should not, be the sole determining factor when a County administrator chooses between requesting additional in-house resources, or

utilizing outside resources through use of professional service contracting. In some instances, such as addressing a short-term need for a specific expertise, or if obtaining objective, outside expertise is of paramount concern, it may not be practical or desirable to consider in-house staff, and a formal cost-benefit analysis may not be appropriate. In other instances, where additional workload is anticipated on a permanent basis, cost should be an important consideration, and some type of documentation of the factors considered, including cost and other factors, should be documented in the file. We have attached, as an example of such documentation, the Department of Audit's justification for utilizing a professional service contract with a public accounting firm to conduct the annual audit of Milwaukee County's financial statements (see **Exhibit 6**). To help ensure that County administrators have appropriate justification for utilizing professional service contracting, we recommend the Department of Administrative Services:

4. *Propose, for County Board consideration, a revision to s. 56.30 of the General Ordinances of Milwaukee County to require administrators to document in the contract file the justification for choosing to utilize a professional service contractor. Such documentation may or may not require a formal cost-benefit analysis, depending on the circumstances involved and the justifications provided in the contract file.*

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## Section 2: Compliance with Professional Service Contracting Requirements

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Once it is concluded that a service is a professional service, contract administrators must comply with numerous requirements as they enter into a contract. Depending on specific circumstances as outlined in the Ordinances and Administrative Manual, such requirements may include, but are not limited to:

- Ensuring there are sufficient funds in the department's budget to pay for the service.
- Obtaining County Board approval.
- Issuing an RFP to solicit competitive proposals from a number of potential vendors.
- Ensuring all required contractual clauses are in the contract.

To help department administrators ensure they follow all contracting requirements, the Department of Administrative Services (DAS) has created a checklist that can be found in the Administrative Manual (Appendix D of s. 1.13). Internal controls within the contracting process, such as review and approval by Corporation Counsel and Risk Management, provide added assurance that requirements are met when they function as intended.

### **Obtaining County Board Approval**

**Contracts of \$50,000 or more require County Board approval.**

Contracts of \$50,000 or more require County Board approval, as well as contract extensions that increase the total value of a contract to \$50,000 or more. This helps prevent departments from 'chaining' lower cost contracts to avoid the need to obtain the required County Board approval.

All 31 contracts with an initial value of \$50,000 or more from our sample of 63 received proper County Board approval.

## **Required Contract Provisions**

Chapter 56.30 contains requirements for several standard contract provisions to protect the best interests of the County. These include, among others, right-to-audit language; indication of reviews by Risk Management, Corporation Counsel and the Office of Community Business Development Partners (CBDP); affirmation of compliance with applicable non-discrimination, Equal Employment Opportunity and Affirmative Action requirements; and a prohibition against contractors beginning work prior to having in place a fully-executed, signed contract.

**We reviewed a sample of 63 contracts for compliance with required provisions.**

We reviewed all 63 contracts in our sample for compliance with these provisions, with the following results.

- Four contracts did not contain the required right-to-audit clause.
- Only one contract of the 63 contracts reviewed did not have the risk manager's signature. It involved a 20-year contract originally signed in 1989 to provide airport aviation ramp management at General Mitchell International Airport.
- All but two contracts had the required sign-off from the Office of Corporation Counsel as to form, content and independent contractor status. One of the two contracts was the same airport ramp management noted above. The other was an annual contract (2006) with the Southeast Wisconsin Regional Planning Council to provide County Surveyor services for the County, a contract that had been reviewed and approved by Corporation Counsel in prior contracts.
- Similar to Corporation Counsel sign-offs, all but two contracts had the required sign off from CBDP. One of the two contracts was the same airport ramp management noted above. The other was a contract (2005) issued by Department of Child Support to provide genetic testing to establish paternity.
- Twenty-six contracts with applicable non-discrimination, Equal Employment Opportunity and Affirmative Action requirements did not have the required form affirming compliance (Form 2532). Eleven other contracts, for which Form 2532 was not a requirement, did not have required language concerning nondiscrimination in the workplace included in the body of the contract. This requirement could have been met if departments had used the language from the example contract contained in the administrative manual.

- Eight contracts had work started prior to the contract being signed by all required parties. This circumvents an important control to help ensure professional service contracts have been reviewed for compliance with important County policy provisions. One of the reasons for this is the inordinate amount of time it took for the contracts reviewed to get through the review process. The prescribed order of review begins with Corporation Counsel, then Risk Management, followed by CBDP. A review of the signing dates by these three departments showed that 17 contracts took between 31 days and 168 days to complete the signoff process. There is no control form documenting the date that a contract is received by one department and forwarded to another.

Of these infractions, non-compliance with the requirements for Form 2532 affirmation, contractual language relating to nondiscrimination in the workplace, and the prohibition on work prior to a fully-executed contract were the most pervasive and troublesome.

To help ensure compliance with requirements for non-discriminatory affirmations and to provide greater accountability for expeditious contract reviews, we recommend DAS:

5. *Add Form 2532 to its checklist of items to verify prior to authorizing professional service contracts for payment (i.e., the encumbrance process).*
6. *Prepare, for County Board consideration, a revision to s. 56.30 of the Ordinances that instructs administrators to seek guidance from s. 1.13 of the Milwaukee County Administrative Manual to help ensure compliance with professional service contract language and other requirements.*
7. *Create a control document to log the date each party (Risk Management, Corporation Counsel and CBDP) receives and relays a professional service contract for review and signature.*

### **Compliance with Request for Proposal Requirements**

Section 56.30 (4)(b)(5) of the Ordinances lists the rules and exceptions that guide departmental contract administrators when soliciting competitive proposals for services using the Request for Proposal (RFP) process. It also lists exceptions to these

requirements, which include emergency situations that require immediate action to preserve property or protect life, health or welfare of persons. The General Assistance - Medical Program is also exempt from the requirement to issue an RFP for services provided by hospitals and other specific medical providers.

We reviewed all 63 contracts in our sample for compliance with RFP requirements, with the following results.

- **Contracts of less than \$20,000** – These contracts do not require the use of an RFP, though the selection process must be documented and maintained for seven years after completion. Our sample included 14 contracts that were for amounts of less than \$20,000. The selection process was not documented in seven of these contracts.
- **Contracts of \$20,000 to \$99,999** – An RFP must be used unless the department administrator determines it would not be cost effective to solicit proposals. Such action must be reported, in writing, with an explanation as to the benefits derived from not seeking proposals, to the County Board when the contract is submitted for approval. We reviewed 26 contracts that fell within this dollar range. In only two instances was an RFP issued.

Of the remaining 24 contracts, the County Board was not notified of a decision not to issue an RFP in 14 contracts. All of these contracts initially were for amounts between 19,999 and \$50,000, where some administrators interpreted the Ordinances to say that contracts of less than \$50,000 did not require either an RFP or County Board notification of a decision not to do so.

- **Contracts \$100,000 or Greater** – We reviewed 23 contracts that were greater than \$100,000. Contracts exceeding this threshold require the use of an RFP unless action is required to protect property or protect life, health or welfare of persons, or if the County Board approves by resolution to waive the RFP process. This was not done for one contract issued by the Zoo for operation of the sky glider.

A total of 21 contracts used RFP's to solicit competition. Of those 21 contracts, two contracts lacked sufficient documentation to assess compliance with applicable requirements. The following summarizes non-compliance with

requirements related to the RFP process for the remaining 19 contracts.

- All 19 contracts complied with the requirement to attempt to solicit a minimum of three proposals.
- Four contracts did not comply with the requirement to provide appropriate notice to prospective vendors of services. At a minimum, administrators need to run an ad in a newspaper serving the Milwaukee area.
- One contract did not meet the requirement for the RFP document to include the evaluation criteria used for selecting the successful bidder.
- The evaluation forms used for evaluating proposals were not kept for seven contracts. The Ordinances do not specify the length of time for retaining documentation relating to the selection process, including forms used by panel members to evaluate RFP. However, the Administrative Manual currently states that such documentation is to be filed for a minimum of seven years after contract completion. This is an increase in the retention length from three years that was called for in the previous issuance of this manual section in December 2000. Noncompliance was noted for each of the seven contracts regardless of which retention period was in force.

**It is important to maintain all documentation substantiating the selection process, to provide transparency and to address future questions should they arise.**

Evaluation documentation was also not maintained for two other contracts. Both contracts involved only one response to the RFP. While maintenance of evaluation documentation in these instances may seem superfluous, it is important to maintain all documentation substantiating the selection process, regardless of the number of respondents, to provide transparency and to address future questions should they arise.

The Administrative Manual has a fairly comprehensive checklist for administrators to follow when entering into professional services contracts. It addresses some of the RFP requirements, but does not include the details relating to the proper vendor notification, proposal evaluation process, and document retention. We recommend that DAS:

8. *Expand s. 1.13 Appendix D of the Administrative Manual to include all requirements related to soliciting competition for professional service contracts.*

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## Section 3: Other Professional Service Contracting Issues

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**Contract administrators currently have no single location that identifies all the requirements related to professional service contracting.**

Contract administrators currently have no single location that identifies all the requirements related to professional service contracting. Authoritative sources that contain professional service contracting requirements include:

- Section 56.30 of the County Ordinances, which provides the bulk of the professional service contracting requirements, including the request for proposal process.
- Section 56.17 of the County Ordinances, which provides the requirements relating to nondiscrimination, equal employment opportunities and affirmative action programs.
- Chapter 42 of the County Ordinances, which provides the requirements for using disadvantaged business enterprises in all County contracting, including professional services.
- Section 1.13 of the County Administrative Manual, which provides detailed instructions for complying with all professional service contracting requirements. This includes several appendixes designed to assist contract administrators as they enter into professional service contracts.
- Memos from DAS notifying department administrators of legislative changes to the Ordinances and any resulting procedural changes. Such memos serve as supplements to the Administrative Manual until it is later updated to reflect the changes.

An up-to-date Administrative Manual arguably comes closest to encapsulating all requirements. It provides valuable procedural guidance for County managers and staff to follow for ensuring County Board requirements are met in all aspects of day-to-day operations in addition to professional service contracting, but it has limitations. For example, the body of the text in s. 1.13 does not address the requirements of s. 56.17 of the Ordinances, though they can be found in the appendixes. Specifically, Appendix B (“Suggested Format for a Professional Service Contract”) includes the requirements. Also, Appendix D

("Checklist for Professional Service Contract Requirements") makes reference the requirement.

Another problem with relying on the Administrative Manual is that it is not timely updated to reflect legislative changes. In July 2002, the County Board revised s. 56.30 to increase certain dollar thresholds. The Controller notified department administrators of these changes in a memo dated September 30, 2002. However, s. 1.13 of the Administrative Manual was not updated to reflect the changes until February 1, 2007.

**Over the past few years, significant improvements have been made to the County's intranet web site.**

Over the past few years, significant improvements have been made to the County's intranet web site to provide management and staff the ability to electronically access various forms and financial information. This direct access has improved management and staff's ability to perform their jobs. However, the Administrative Manual has not been brought on-line in this fashion. Although DAS placed s. 1.13 of the Administrative Manual in the Forms Library of Lotus Notes this past summer (in conjunction with Form 1684), it has not prominently publicized this placement.

A comprehensive, up-to-date, electronically accessible Administrative Manual can help all users, including contract administrators, better perform their jobs. We recommend that the Department of Administrative Services:

9. *Continue in its efforts to provide County management and staff with on-line access to the most current version of the entire Administrative Manual, and promote the availability of the on-line Manual among County administrators upon completion.*

#### **Inconsistency Within Section 56.30**

Prior to July 2002, County Board approval was required for professional service contracts of \$20,000 or greater. This was the same threshold at which the RFP process was required to be used to seek proposals (with limited exceptions). If not doing so

was determined to be cost effective, departments were required to notify the County Board in writing, with an explanation as the benefits derived from not seeking proposals “when the contract is submitted for approval.”

When the County Board increased the threshold requiring its approval for contracts to \$50,000 in July 2002, it did not make a similar, specific change to the threshold for when it needed to be notified if a department chose not to use the RFP process. However, the phrase “when the contract is submitted for approval” was kept in the Ordinances (and remains currently). This has been interpreted by some administrators that the RFP notification threshold also increased to \$50,000, since contracts of lesser value do not need to be submitted for approval. The County Board was not notified of the decision not to use the RFP process for all eight contracts with values from \$20,000 to \$49,999 included in our sample that were not otherwise exempted from the RFP process.

The Controller explained the changes to s. 56.30 in a memo to all department administrators dated September 30, 2002. Concerning the RFP process, it states “The limits on when to use request for proposals (RFP’s) for professional service contracts remain the same.” A more conclusive interpretation was made when s. 1.13 of the Administrative Manual was revised in February 2007. It now states, for contracts values of \$20,000 to \$99,999, in part:

“The use of an RFP is required, unless the department administrator determines it would not be cost-effective, to seek proposals. A department decision to not use an RFP must be reported, in writing, with an explanation of the benefits derived from not seeking proposals, to the County Board. Any reports submitted to the board regarding the departments’ decisions not to use an RFP process should be for information only. Contracts under \$50,000 do not require County Board approval. However, an informational report stating that you did not use the RFP process should still be reported to your standing committee.”

This clearly reflects the DAS interpretation of the County Board's intent.

However, contract administrators relying solely on the Ordinances might not have come to that same interpretation. Nearly one-third of the departmental contract administrators we interviewed stated that they rely primarily on the Ordinances rather than the Administrative Manual. Thus, they would not necessarily be aware of this or any other clarifications that the Administrative Manual may provide.

**It is not clear if the Administrative Manual is in sync with County Board intent regarding reporting thresholds for the RFP process.**

It also raises the question of whether the clarification noted in the current Administrative Manual is the intent of the County Board. Section 56.30 needs revision to clearly establish the County Board's intent with respect to reporting back to the County for contracts between \$20,000 and \$50,000. If that intent is different than the current wording of the Administrative Manual, s. 1.13, then appropriate changes would also be required of that document. We therefore recommend that DAS:

*10. Prepare, for County Board consideration, language revisions to s. 56.30 (4)(b)(5)(a)(1) of the County Ordinances that clarify the contract dollar thresholds which necessitate reports to the County Board of the decision by department administrators not to utilize the RFP process. Also, ensure that any changes match corresponding Administrative Manual instructions.*

### **Encumbering Professional Service Contracts**

The encumbrance process (reserving appropriated funds for committed contractual obligations) serves as an important internal control to prevent departments from spending budgeted funds that have been committed for other purposes. In the case of professional service contracting, departments could potentially commit the County to contracts for which funds may not be available when payment is requested if they are not first encumbered.

Each department entering into a professional service contract must complete Form 1684. A copy of this form is to be sent to the Accounts Payable section of DAS. The form serves as the basis for encumbering funds to cover the contract amount for the current year. As departments request payment by Accounts Payable, DAS lifts the encumbrance and posts the payment to the contract. This process serves as a control to ensure only payments are made for authorized, encumbered contracts.

However, this control can be circumvented in cases when a department does not submit a Form 1684 to DAS, and when payments for that contract are not made via the normal check request process through DAS. This can occur when payments to contractors are made in the form of electronic fund transfers (EFT).

**Requests for EFT payments are made through the Treasurer's Office, effectively bypassing current controls for ensuring payments are made only on properly authorized, encumbered contracts.**

Requests for EFT payments are made through the Treasurer's Office, effectively bypassing DAS and the associated controls in place there for ensuring payments are made only on properly authorized, encumbered contracts. Authorized department staff complete a form that is sent to the Treasurer, who in turn makes the payment directly to the vendor's financial institution.

The contract that brought this issue to light was one entered into by the Department on Aging, where we were looking at contracts involving the long-term use of professional services contracting in lieu of hiring someone to fill a position. Aging submitted a Form 1684 in 2004, the first year of a contract to provide fiscal management services, for \$500,000. The contract has been extended annually since then. However, Form 1684 was not submitted in any of the subsequent years, with contract payments made via EFT. Because no Form 1684 was prepared, DAS did not encumber the contract since 2004.

The Treasurer's Office does not check with DAS to make sure that a properly authorized, encumbered contract is on file before

making EFT payments because current procedures do not call for it. In this case, Aging's fiscal management contract did have County Board approval. However, if the contract had not been approved, the Treasurer's Office would still have made the payment under current procedures.

This is a relatively isolated instance from a professional service standpoint, since nearly all professional service contracts are paid through the normal check request process. However, the County makes greater use of EFT payments for non-professional service contracts, such as payments by the County for medical benefits. EFT payments totaled \$506.9 million in 2006 and \$519.9 million in 2007. Essentially all of these payments were made without funds being encumbered first.

The use of EFT to pay contractors does not relieve departments of the responsibility for preparing Form 1684 and submitting it to DAS so that contract amounts can be properly encumbered. Controls need to be improved to ensure EFT payments are made on properly authorized, encumbered contracts, and that EFT payments are used to offset encumbered amounts. Also, since Form 1684 serves as the source data for the professional service contracts reported quarterly to the County Board by the Controller, its proper use is needed to provide a complete representation of professional service contracting.

The safeguards provided by a properly functioning encumbrance process need to be extended to all EFT payments requiring encumbrances but in which funds are not first encumbered, not just limited to payments for professional service contracting. We recommend that DAS:

- 11. Work with the Treasurer's Office to implement procedures relating to EFT payments that will provide the necessary controls for ensuring payments are made only on properly authorized, encumbered contracts.*

## **Revenue Contracts**

Revenue contracts represent a small segment of contracts that can be considered professional service contracts. An example is a contract with a collection agency to attempt collection on amounts owed to the County. Accounting for revenues and the associated expenses for this type of contract generally takes one of two approaches. The first is to show a full accounting on the books for all revenues and expenses. The other method is to have the contractor offset the revenues collected with the expenses incurred and submit just the net revenues.

The method chosen can impact whether or not the contract is reflected on the Controller's quarterly report. If the County collects all revenues and separately pays the contractor all associated expenses, then existing accounts payable controls should allow for only authorized payments. In the case of a professional service contract, a Form 1684 would be required documenting the fact that an authorized, approved contract is on file.

However, if the contractor offsets revenues, there is no need to encumber funds as there is nothing to pay out. Thus, departments may not feel the need to complete a Form 1684. We noted this problem with collection agencies under County contract, where in two contracts (one with Behavioral Health, the other with the Clerk of Circuit Court) the departments did not submit a Form 1684 to DAS.

We saw no evidence of contracting procedures being circumvented, but the potential exists for a contract to avoid following professional services contracting procedures when there are no payments to contractors for expenses. However, collection agencies do represent a professional service, thus completion of the Form 1684 is required, regardless of the method of accounting for expenses.

For the Controller's quarterly report to be truly comprehensive, Form 1684 needs to be prepared for all types of professional services contracts, regardless of how funds are accounted for or paid out. We recommend that DAS:

- 12. Reinforce the requirement to complete Form 1684 for all professional service contracts and extensions, including those paid via EFT and revenue-generating contracts.*

## Audit Scope

In response to County Board Resolution [File No. 07-79], the Department of Audit reviewed the procedures related to the execution of professional service contracting. This audit was conducted under the standards set forth in the United States Government Accountability Office *Government Auditing Standards (2003 Revision)*. We limited our review to the areas specified in this Scope Section. During the course of the audit, we:

- Reviewed applicable Milwaukee County Ordinances, related Administrative Manual sections, and other authoritative directives discussing policies and procedures relating to professional service contracting.
- Reviewed past audit reports and Adopted Budgets.
- Reviewed and examined quarterly reports on professional service contracts prepared by the Controller and submitted to the County Board covering the period 2004–2007.
- Sampled 63 contracts and related extensions for the period 2004–2007 for compliance with applicable rules and regulations.
- Reviewed Advantage financial data related to professional service contracting and related encumbrances.
- Interviewed department administrators responsible for professional service contracting.
- Interviewed management for the offices of Corporation Counsel, Risk Management, Community Business Development Partners and the Controller regarding their involvement in reviewing professional service contracts.
- Contacted the State of Wisconsin regarding its process for professional service contracting.



**COUNTY OF MILWAUKEE**  
INTEROFFICE COMMUNICATION

**Department of Administrative Services**  
Cynthia Archer, Director

DATE: December 17, 2008

TO: Jerome Heer, Director of Audits

FROM: Cynthia Archer, Director, Department of Administrative Services

SUBJECT: Response to audit of Professional Service Contracts

The Department of Administrative Services (DAS) appreciates the opportunity to respond to the Audit of Professional Service Contracting.

In general, we agree with the recommendations that are being made in the report. The goal of any audit is to point out where improvements can be made in procedures. It is our sense that professional service contracting can be improved through better communication of expectations with departments.

- Departments need to have a clear definition of what constitutes a professional service.
- The ordinances and administrative procedures needs to be clarified regarding expectations of departments when entering into professional service contracts.
- The procedures and any communications regarding professional services need to be readily accessible by management.
- Departments need to clearly document their decisions regarding the contracting for these services.
- Verification needs to be performed by departments that all contracting steps have been completed. The verification will also include a review, which is specific to their area of responsibility, by Corporation Counsel, Risk Management, Office of Community Business Development Partners, and DAS – Accounts Payable.

The DAS will respond to each point raised by the audit.

- (1) Coordinate a workgroup comprised of staff from the Office of Corporation Counsel, DAS and County Board Staff, to recommend, for County Board consideration, revisions clarifying and clearly distinguishing professional services governed by s. 56.30 from contractual services governed by s. 32.36 of the Ordinance.

Response: The Department of Administrative Services agrees with this recommendation and will proceed with scheduling a meeting of the workgroup as noted.

- (2) Remind Department administrators of the availability of Corporation Counsel as a resource in determining if a desired service qualifies as a professional service, and revise Administrative Manual Section 1.13 to eliminate reference to the Purchasing Standardization Committee as such a resource

Response: The Department of Administrative Services will prepare a memo that will go out on an annual basis to remind departments of the administrative procedure regarding professional services. Revisions will be made to the Administrative Procedure 1.13 to eliminate the Purchasing Standardization Committee from the process of determining a professional service.

- (3) Evaluate the purpose, composition and performance of the Purchasing Standardization Committee in light of the responsibilities with which that committee has been charged under s. 32.23 of the Ordinances and recommend, for County Board consideration, appropriate revisions.

Response: The Procurement Division of the Department of Administrative Services will make this review and will provide recommendations for revisions, as appropriate.

- (4) Propose, for County Board consideration, a revision to Chapter 56.30 of the General Ordinances of Milwaukee County to require administrators to document in the contract file the justification for choosing to utilize a professional service contractor. Such documentation may or may not require a formal cost-benefit analysis, depending on the circumstances involved and the justifications provided in the contract file.

Response: The Department of Administrative Services believes that departments should always document a professional service selection process. Suggestions for documenting the selection process will be included in a revision to the current administrative procedure. Historically, outside professional services are obtained because of the professional's expertise. A revision could be made to s. 56.30 that requires departments to document their selection process. The revision will include a suggested time period to maintain these records.

- (5) Add form 2532 (EEOC form affirming compliance with equal employment opportunity and affirmative action) to its checklist of items to verify prior to authorizing professional service contracts for payment (i.e. the encumbrance process).

Response: DAS will add the form to the checklist included in the administrative procedure. The checklist is used by departments to verify that they have performed all steps of the professional service contract process. DAS will amend the administrative procedure to require Corporation Counsel to ensure the inclusion of Form 2532 (EEOC compliance) as part of their review.

- (6) Prepare, for County Board consideration, a revision to Chapter 56.30 of the Ordinances that instructs administrators to seek guidance from Section 1.13 of the Milwaukee County Administrative Manual to help ensure compliance with professional service contract language and other requirements.

Response: An amendment will be made to s. 56.30 of Ordinance to reference Administrative Procedure 1.13.

- (7) Create a control document to log the date each party (Risk Manager, Corporation Counsel and CBDP) receives and relays a professional service contract for review and signature.

Response: DAS will include a control document for signatures as part of the administrative procedure for use by departments.

- (8) Expand Section 1.13 Appendix D of the Administrative Manual to include all requirements relating to soliciting competition for professional service contracts.

Response: The Department of Administrative Services will work to update the administrative procedure on professional services (1.13) to include all requirements relating to soliciting competition.

- (9) Continue in its efforts to provide County management and staff with on-line access to most current version of the entire Administrative Manual, and promote the availability of the on-line Manual among County administrators upon completion.

Response: The Department of Administrative Services will proceed with putting administrative procedures on-line on the intranet, so that they are available to department administrators.

- (10) Prepare, for County Board consideration, language revisions to Chapter 56.30 (4)(b)(5)(a)(1) of the County Ordinances that clarify the contract dollar thresholds, which necessitate reports to the County Board of the decision by department administrators not to utilize the RFP process. Also ensure that any changes match corresponding Administrative Manual instructions.

Response: The Department of Administrative Services agrees with this recommendation and will propose that request for proposal requirements match County Board approval requirements. Ordinance changes could be similar to the following: All operating contracts less than \$50,000 do not require the use of an RFP, however RFPs are recommended. For contracts between \$50,000 and

\$100,000 departments should use RFPs. However, if an RFP is not utilized, the department will notify the County Board that an RFP was not used when requesting approval of the contract. All contracts greater than \$100,000 will require the use of an RFP.

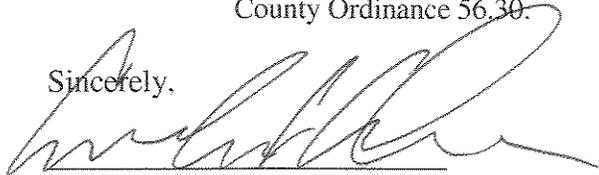
- (11) Work with the Treasurer's Office to implement procedures relating to EFT payments that will provide the necessary controls for ensuring payments are made only on properly authorized, encumbered contracts.

Response: Central Accounts Payable and the Treasurer's office have had initial discussions on this issue. The Treasurer's office would like all EFT documents to be reviewed and approved by the Department of Administrative Services prior to payment being made by the Treasurer. Final discussions on this issue will occur in the next several months.

- (12) Reinforce the requirement to complete Form 1684 for all professional service contracts and extensions, including those paid via EFT and revenue generating contracts.

Response: The Department of Administrative Services will remind departments that all professional service contracts including those paid by check request, EFT or generating revenue will require review by the DAS to ensure compliance with County Ordinance 56,30.

Sincerely,



Cynthia Archer  
Director, Department of Administrative Services

Cc: Douglas Jenkins, Department of Audit  
Scott Manske, DAS, Controller  
Susan Walker, DAS - Accounts Payable

**56.30. Professional services.**

(1) *Definitions.* The meanings of certain terms used in this section is as follows, unless the context otherwise provides:

(a) *Professional service* means services, the value of which is substantially measured by the professional competence of the person performing them and which are not susceptible to realistic competition by cost of services alone. The services provided must be materially enhanced by the specific expertise, abilities, qualifications and experience of the person that will provide the service. Professional services shall typically include services customarily rendered by architects; engineers; surveyors; real estate appraisers; certified public accountants; attorneys; financial personnel; medical services, except when such services are delivered to clients of the general assistance-medical program or to county employes as part of a workers compensation claim and social services; system planning; management and other consultants; and services for promotional programs.

(b) *Service* means the furnishing of labor, time or effect by a contractor, not involving the delivery of a specific end product other than usual reports and/or drawings which are incidental to the required performance.

(c) *Request for proposal* means all documents, whether attached or incorporated by reference, used for soliciting proposals.

(d) *Contractor* means a firm or individual who formally undertakes to do anything for another.

(e) *Contract* means an agreement between two (2) or more persons to do or not to do something.

(f) *Medical service* means services provided by a licensed or recognized health care professional, professional group, ambulance or medical transportation services operated by governmental units, medical laboratories or companies of medical supplies or equipment is provided to individuals who qualify for assistance under the general assistance-medical program or county employes whose injury is considered a workers compensation claim. Hospitals, community-based clinics, faculty physicians and surgeons or other physicians operating from Froedtert Memorial Lutheran Hospital, non-municipality operated ambulance and medical transportation providers are excluded from this definition.

(2) *Policy.*

(a) *General policy statement.* All county departments and institution administrators are responsible for procuring professional services in accordance with the provisions of this section. However, the office of the county executive and the county board shall be exempt from the provisions contained herein as shall be the department of administration for the purpose of securing credit rating services related to debt issuance and administration.

(b) *Disadvantaged business enterprise requirement.* All county departments and institutions administrators are required to notify the disadvantaged business development (DBD) division in writing prior to entering into professional services contracts. Annual percentage goals for DBE participation on professional services contracts will be established as set forth by county ordinance. The procedures to be followed by departments regarding DBE participation shall conform to provisions as contained in chapter 42. No professional services contract shall be issued without review and written approval by the DBD division that all provisions of chapter 42 regarding disadvantaged business participation have been met.

(c) *Fiscal constraint statement.* Notwithstanding any other provisions of section 56.30, during a period of fiscal constraint the county board may, by resolution, adopt a procedure which requires committee on finance and audit review and county board approval of all professional service expenditures prior to execution of said contracts.

(3) *Availability of appropriations.* It is the responsibility of the administrator who will sign a professional services contract to insure that monies are available in the appropriate budget account for the expenditures required by the contract.

(4) *Professional services procedures.* It shall be the responsibility of the administrator to conform with the following provisions when entering into a professional services contract and expending budgeted funds:

(a) *Professional services--Capital improvements.* The following conditions shall apply to all capital projects.

(1) During its annual budget process, departments shall provide a list to the county board of which capital projects contained in the recommended budget are intended to require the assistance of a professional service consultant. Departments are authorized to enter into contractual services or professional services agreements as may be required for specific capital improvement projects which have been approved by the county board through the budget process. Expenditures shall only be for those projects and professional services specifically identified in the budget write-up reviewed by the committee on finance and audit during the budget review process and approved by the county board, or for those projects approved by action of the county board. The budget write-up shall contain specific information as to the scope of the project, professional services required and estimated cost of the professional services work to be performed. The department of public works shall provide in February of each year to the committee on finance and audit and the committee on transportation, public works and transit an updated report on public works capital projects requiring the use of a professional services contract. Any professional service work costing more than twenty-thousand dollars (\$20,000.00) which is not identified in the February report shall require county board approval.

(2) All contracts in excess of twenty-thousand dollars (\$20,000.00) shall be solicited following a request for proposal process as outlined further in this ordinance.

(b) *Professional services--Non-Capital.*

(1) For professional services resulting in an expenditure of two thousand dollars (\$2,000.00) or less, a departmental purchase order or purchase card may be used for the purchase of professional services. County board approval is not required provided monies are available in the appropriate budget account.

(2) For a professional services contract with a value greater than two thousand dollars (\$2,000.00) and less than fifty thousand dollars (\$50,000.00), county board approval is not required provided monies are available in the appropriate budget account for the expenditures required by the contract.

(3) County board approval.

(a) If a professional services contract with a value greater than two thousand dollars (\$2,000.00) and less than fifty thousand dollars (\$50,000.00), entered into by a department administrator is to be extended or amended to provide additional reimbursement which extends the total reimbursement beyond fifty thousand dollars (\$50,000.00) to the same vendor, county board approval shall be required for each extension.

(b) For a professional services contract with a value of fifty thousand dollars (\$50,000.00) or more, approval by the county board is required. Such approval may take place as part of the county board's adoption of the annual county budget. If approval does not take place as part of the adopted budget, then review by the appropriate county board standing committee and approval by the county board is required. If immediate action is required to preserve property or protect life, health and welfare of persons, county board approval may be waived, provided such action shall be reported, in writing, within forty-eight (48) hours after initial emergency action, to the county board, the county executive and department of administration.

(4) County board approval is not required for reimbursement for medical services as defined under subsection 56.30(1)(f) when those services are provided to general assistance-medical program clients in accordance with chapter 32.90 or to county employes as a workers compensation claim provided that sufficient funds are available at the time the invoice for service is submitted in the appropriate expenditure amount.

(a) The general assistance-medical program is specifically excluded from issuing payments to any hospital, community based clinic, faculty physicians and surgeons or other physicians operating from Froedtert Memorial Lutheran Hospital, non-municipality operated ambulance or medical transportation provider unless a specific contract for such service has been reviewed and approved by the county board. The general assistance-medical program is exempt from the requirement to issue a request for proposal as defined in subsection 56.30(5) for services provided by hospitals, ambulance or medical transportation providers. The general assistance-medical program must issue a request for proposal whenever soliciting services which could be provided by a community based clinic, a primary care clinic, or any service which could be construed as a primary medical service.

(b) The risk management division is allowed to issue payments to hospitals whenever services have been rendered to county employes as part of a workers compensation claim.

(5) *Request for proposal.*

(a) *When required.* When it is estimated that a contract for professional services has a value of twenty thousand dollars (\$20,000.00) and over, it is required that a request for proposal (RFP) be used to attempt to solicit a minimum of three (3) proposals. Department administrators shall give appropriate notice to prospective vendors of services to be retained. At a minimum, such notice shall include publication of an ad in a newspaper serving the Milwaukee area. The use of an RFP is discretionary for any professional service contract with a value of less than twenty thousand dollars (\$20,000.00). If an RFP is used or not, it still is required to document the process and the reasons shall be documented in writing by the administrator and retained in departmental files for a period of seven (7) years after contract completion. Documentation shall include the RFP, memos, proposals, score sheets, analyses, contracts and any other document used in determining the award of a contract.

(1) For a contract with an estimated value between twenty thousand dollars (\$20,000.00) and one hundred thousand dollars (\$100,000.00), the request for proposal procedure need not be used if it is determined by an administrator to be cost effective to the county not to seek proposals. Such action shall be reported, in writing, with an explanation as to the benefits derived from not seeking proposals, to the county board when the contract is submitted for approval.

(2) The request for proposal procedure need not be used for a contract with an estimated value of twenty thousand dollars (\$20,000.00) or more, if immediate action is required to preserve property or protect life, health or welfare of persons. Such action shall be reported in writing within forty-eight (48) hours after the initial emergency action to the county board, county executive and department of administration. Payments shall not be restricted by normal budget limitations. Appropriation transfers, if required, shall be initiated in accordance with fiscal procedures.

(3) The request for proposal procedure must be used for all contracts with an estimated value of one hundred thousand dollars (\$100,000.00) or more unless action is required to protect property or protect life, health or welfare of persons, or in circumstances where contractual services are approved by specific county board action.

(b) *Content.* The request for proposal shall contain the evaluation criteria which will be used to select the successful contractor. The relative importance of each of these items will depend to some degree on specific services being sought. It is essential that the RFP enumerate the evaluation criteria which will be used to select the successful contractor.

(c) *Evaluation procedure.* More than one (1) person shall evaluate all proposals. Oral presentations should be used to supplement the written proposal if it will assist in the evaluation procedure. The firms to be invited to make an oral presentation can be determined after the initial review and ranking of the proposals based on the criteria outlined in the RFP.

(6) *Contract.*

(a) All contracts, excluding departmental purchase orders, shall be reviewed by the corporation counsel to determine if they meet the definition of professional services.

(b) *Approval.* The contract must be approved by the office of the corporation counsel prior to execution.

(c) All provisions of the Code governing administration of contracts must be followed.

(d) All contracts which have been approved by action of the county board shall contain language referencing the county board file number and date of county board approval.

(e) All professional service contracts shall contain a provision which provides that the contractor shall permit the authorized representatives of the county auditor, after reasonable notice, the right to inspect and audit all data and records of contractor related to carrying out the contract for a period of up to three (3) years after completion of the contract.

(f) All contracts will be reviewed and approved, in writing, by the county's risk manager for financial responsibility and liability management, including appropriate insurance provisions and modifications in indemnity agreements.

(7) *Department administrator reporting requirement.* All department administrators are responsible for informing the controller in writing whenever a professional service contract is initiated. Department administrators are to inform the controller of such contracts in a standardized format on a form to be developed by the department of administration.

(a) *Content.* Such reports shall be prepared in four (4) parts and include the following information:

- (1) Department name and number.
- (2) Date approved by county board and file number.
- (3) Dollar amount of contract.
- (4) Account description and account number charged.
- (5) Name of professional service vendor under contract.
- (6) Length of time of contract.
- (7) Purpose of contract.
- (8) Selection of qualified DBE firm.

(b) *Distribution:*

Original copy to controller.

One (1) copy retained by department administrator.

(8) *Controller responsibility.*

(a) The controller shall, on a quarterly basis, summarize the reports received from department administrators concerning professional service contracts and send one (1) copy to the committee on finance and audit and one (1) copy to the county executive.

(b) The controller shall deny payment for any payment request for professional services submitted by a contractor to an administrator if all

conditions of this chapter have not been met. The controller shall report such denials and the reason for denial to the committee on finance and audit along with the quarterly report. In such cases, the administrator may appeal the decision to the finance and audit committee.

(9) *Administrator responsibility.* It is the responsibility of the administrator, prior to permitting a professional service contractor to perform any work for the county, to comply with all sections of this chapter. Furthermore, no work shall be performed by any professional services contractor unless or until a written contract has been executed and signed by all appropriate officials.

(10) *Corporation counsel authority.*

(a) Any contrary provision of these ordinances notwithstanding, the corporation counsel may enter into a professional service contracts to obtain the professional services without regard to the requirements of this section with respect to requests for proposals and prior county board approval, without regard to the goals and procedures established under chapter 42 of these ordinances and without regard to any other ordinance or resolution which would operate to constrain the corporation counsel's ability to enter into a professional services contract if the corporation counsel determines, in the exercise of the corporation counsel's professional judgment, (i) that such professional services are necessary to assist Milwaukee County to prepare for or prosecute litigation arising out of the enhanced pension benefits which became effective January 1, 2001 in order to assist the likelihood of success of the litigation, and (ii) that the interests of Milwaukee County require timely action and flexibility which preclude the delay inherent in the procedures prescribed in this section and in chapter 42 of these ordinances.

(b) The corporation counsel shall make every reasonable effort to comply with all the requirements of this section, chapter 42, and any other ordinance or resolution affecting professional services contracts to the extent that the circumstances of the litigation and protection of the interests of Milwaukee County permit.

(c) The corporation counsel shall provide a confidential report in a timely manner to the committee on judiciary, safety and general services with respect to any contract entered into under the authority of this subsection.

**Summary of Professional Service Contracting  
Totals by Department and Large Divisions  
2004 – 2007**

<u>Department/Division</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>
County Board	\$50,000	\$49,500	\$57,000	\$49,500
Audit	\$340,000	\$345,000	\$404,393	\$441,775
Office of Community Business				
Development Partners	N/A	\$60,000	\$73,887	\$57,823
Civil Service Commission	\$7,319	\$7,319	\$7,252	N/A
Personnel Review Board	\$7,928	\$9,328	\$25,710	N/A
Corporation Counsel	\$107,804	\$131,000	\$360,450	\$85,100
DAS – Office for Persons w/ Disabilities	\$119,700	\$136,250	\$95,859	\$131,141
DAS – Labor Relations	N/A	N/A	N/A	\$150,000
DAS – Human Resources	\$69,743	\$83,210	\$249,999	\$24,000
DAS – Risk Management	\$29,000	\$28,000	\$29,750	\$29,750
DAS – Admin. & Fiscal Affairs	\$301,057	\$50,000	\$694,188	\$281,655
DAS – Procurement	N/A	N/A	N/A	\$15,200
DAS – IMSD	\$17,100	\$436,634	\$1,802,713	\$1,150,543
DAS – Employee Benefits	N/A	N/A	N/A	\$400,000
DAS – Economic & Community Dev.	\$89,000	\$83,000	\$80,000	\$172,076
Non-Departmental (non-construction)	\$921,192	\$1,935,916	\$1,791,900	\$2,053,305
Capital Projects	\$6,155,178	\$7,797,658	\$5,647,346	\$4,006,264
Combined Court Related Operations	\$3,892,702	\$3,890,269	\$3,920,727	\$4,344,527
Child Support	\$528,181	\$521,181	\$782,177	\$664,192
Treasurer's Office	N/A	\$35,000	\$192,000	\$253,500
Office of the Sheriff	\$2,926,971	\$2,125,209	\$2,312,571	\$2,629,217
House of Correction	\$6,002,101	\$5,169,976	\$4,677,602	\$4,629,909
District Attorney	\$26,018	\$69,289	\$8,700	\$688,193
Medical Examiner	\$197,800	\$70,550	\$128,500	\$79,300
DPWT – Airport	\$4,879,157	\$6,921,652	\$5,262,981	\$6,436,016
DPWT – Architectural, Engineering & Environmental Services	\$1,102,031	\$1,115,701	\$405,077	\$554,246
DPWT – Highway Maintenance	\$5,700	\$7,900	\$5,000	\$5,000
DPWT – Fleet Management	\$1,200	\$1,200	\$6,000	N/A
DPWT – Transit/Paratransit System	\$28,986	N/A	N/A	\$2,250
DPWT – Facilities Management	N/A	\$1,205	\$635	\$1,950
DPWT – Director's Office	\$15,000	N/A	\$120,000	N/A
DHHS – Behavioral Health Division	\$5,249,437	\$7,288,326	\$7,425,111	\$7,353,794
DHHS – County Health Programs	\$10,833,332	\$10,290,036	\$10,193,177	\$7,578,350
Department on Aging	\$927,671	\$255,238	\$199,589	\$294,490
Health and Human Services	\$1,370,325	\$1,679,704	\$1,812,806	\$1,846,737
Parks, Recreation & Culture	\$258,025	\$24,500	\$123,740	\$584,875
Zoological Department	\$1,660,272	\$1,696,729	\$948,949	\$1,543,899
University Extension Service	<u>\$140,000</u>	<u>\$140,000</u>	<u>\$140,000</u>	<u>\$ 140,000</u>
<b>Totals</b>	<b>\$48,259,930</b>	<b>\$52,456,480</b>	<b>\$49,985,789</b>	<b>\$48,678,577</b>

Source: Controller's Quarterly Reports to Committee on Finance and Audit.

### Cost Comparison Factors

Borrowing from a State of Wisconsin model, we identified several factors administrators should consider when conducting a high-level cost comparison to determine the cost-effectiveness of using professional service contracts versus adding or deploying existing in-house County positions and resources.

However, certain complexities of Milwaukee County's accounting and budgeting environment must be understood and recognized when undertaking a comparison of the relative cost-effectiveness of outside contracted services, as opposed to using in-house staff. The concepts of fixed and variable costs are essential underpinnings in any cost-benefit analysis. In considering a financial decision—for example, hiring the services of an accountant at an hourly rate vs. hiring a staff accountant—fixed costs are those expenditures that will not change, regardless of the decision made. This notion is particularly important with respect to Milwaukee County's fringe benefit costs. As will be discussed in detail below, a significant portion of County fringe benefit costs are associated with retired former employees. These so-called 'legacy' costs are property rights of those individuals and their beneficiaries under Wisconsin law, and as such Milwaukee County is obligated to pay those costs without regard to the number of current employees that are added or subtracted from its workforce. As a result, even though Milwaukee County budgets for legacy costs on a per-employee basis, the elimination of a budgeted position will **not** eliminate the budgeted legacy costs associated with that position. In other words, legacy costs are *fixed costs*.

On the other hand, variable costs increase or decrease, depending upon the decision made. Regarding in-house positions, salaries, social security taxes, and the non-legacy portion of fringe benefit costs (so-called 'active' fringe benefit costs) are all variable costs that will increase with the addition of County positions, and decrease with the elimination of positions.

It is important to note that each of the cost factors and adjustments identified must be considered in the context of the particular circumstances present for each contracting decision. Whether or not a specific cost factor should be included or adjusted may depend upon the nature of the professional service contract being considered, as discussed below. Further, cost alone may not be the determining factor. Consideration of such factors as the need for outside objectivity, the longevity of the need, and uneven workflows, among others, may outweigh cost differentials in many circumstances.

Key internal cost factors needed for comparisons to outside contract costs include:

- Wage rates for comparable in-house positions;
- Adjustments for paid leave and fringe benefits, if applicable;
- Space and utility costs, if additional expense would be incurred, or if the service is performed long-term, a proportionate share of such costs;
- Equipment and furnishings, if additional expense would be incurred, or if the service is performed long-term, a proportionate share of such costs;
- Transportation costs, if applicable; and
- Other miscellaneous costs and intangibles, if applicable.

Factors not included in this analysis were indirect costs such as payroll, human resources, accounting, etc. under the assumption that, in most cases, such costs would not be increased or decreased materially, regardless of the County's decision to contract for outside services or perform them in-house. In the event that the decision involved an entire program, such as when Milwaukee County closed John L. Doyne Hospital, then such indirect expenses would need to be estimated and taken into account under "other miscellaneous costs."

### **Wage Rates for Comparable In-House Positions**

In many instances, the County has in-house positions capable of providing identical or similar services to those for which a professional services contract is being considered. If a current in-house position does not exist, an assumption would need to be made regarding the likely wage rate should the County create an in-house position.

### Adjustments for Paid Leave and Fringe Benefits

In most cases, the hourly wage rate for a County position must be adjusted to reflect the cost of paid leave and other fringe benefits. This is because such costs are typically embedded in the hourly rates charged for personnel under a professional services contract, and the County pays the contractual hourly rate only for hours worked. When the County pays an employee, the employee's hourly rate is paid both for hours worked, and for hours charged to various leave categories such as vacation, holidays, and sick time. The amount of paid leave per employee can vary widely by position and by department throughout the County, due to the seniority of staff, the nature of job responsibilities, and other factors.

To illustrate the method of adjusting for paid leave, assume a hypothetical County employee works an average of about 1,750 hours, or about 84% of a standard 2,080-hour work year. Further assume that the County employee is paid \$25 per hour. To compare to a contractual hourly rate of \$75, an administrator would begin by adjusting the hourly rate of the County position by dividing 25 by .84, resulting in an adjusted County hourly rate of \$29.76. An additional adjustment of 7.65% would be made to reflect the employer's cost of Social Security and Medicare obligations, resulting in an adjusted County hourly rate of \$32.04 in this example.

Next, the administrator would adjust the County hourly rate to reflect the cost of fringe benefits. For 2008, the County's fringe benefit cost is comprised of two components. A fixed cost component of \$26,821 per employee includes health care, dental care, life insurance and all other non-pension benefit costs. A variable cost component, calculated at the rate of 19.86% of each employee's salary, covers pension costs.

Because the County's obligation to pay current retirees' pension benefits (i.e., 'legacy' costs) remains unchanged regardless of the size of the current workforce, it should **not** be considered when determining the relative cost-effectiveness of using in-house or contracted positions. That is to say, legacy costs will not increase or decrease, regardless of the decision. For this reason, two components of Milwaukee County fringe benefit costs have been segregated into 'Active' and 'Legacy' portions.

For 2008, the Active portion of Milwaukee County employee fringe benefits is \$13,835 per employee for health care and other benefits, and 14.72% of salary for pension costs. The fixed cost health care component equates to \$6.65 per hour using a standard 2,080 hour work year. Adjusting once again for paid time off, the adjusted hourly rate for the Active health care component of fringe benefit costs in our example is \$7.92 (\$6.65 divided by .84). Similarly, the Active pension component of fringe benefit cost on a \$25 per hour salary equates to \$3.68 (\$25 x .1472) per hour. Adjusting this component for paid time off results in an adjusted pension component cost of \$4.22 (\$3.68 + \$0.54) per hour. Thus, in our example of a County employee with a \$25 per hour salary, an administrator comparing internal labor costs to an external contractual rate would use an

adjusted County employee cost (wages and benefits) rate of \$44.18. The adjustments described in this example are shown in the following table.

<b>Hypothetical Example of Wage and Fringe Benefit Adjustments for Comparing County Positions to Hourly Contract Rates</b>	
<u>Title</u>	<u>Title</u>
Standard Full-Time Work Year	2,080 Hours
Average Paid Time Off	-330 Hours
Average Work Time	1750 Hours
Adjustment Factor	0.84 (1,750 / 2,080)
<b>Base Hourly Wage</b>	<b>\$25.00</b>
Adjusted for Paid Time Off	\$29.76 (\$25.00 / 0.84)
Adjusted for Employers' Social Security	<b>\$32.04</b> (\$29.76 x 1.0765)
Active Health Care Hourly Rate	\$6.65 (\$13,835 / 2,080)
Adjusted for Paid Time Off	<b>\$7.92</b> (\$6.65 / 0.84)
Active Pension Cost Hourly Rate	\$3.68 (\$25.00 x 1472)
Adjusted for Paid Time Off	<b>\$4.38</b> (\$3.68 / 0.84)
<b>Total Adjusted Hourly Rate</b>	<b><u>\$44.34</u></b> (\$32.04 + \$7.92 + \$4.38)
Source:	Base wage and average time off are hypotheticals; Social Security rate is actual; fringe benefit costs are budgeted figures from DAS 2008 Budget Instructions.

### **Space and Utility Costs**

It may be appropriate for Department administrators to consider the costs of space and utility charges, whether internally generated (i.e., cross-charges from Facilities Management) or externally generated (i.e., leasing space in a privately owned building), when comparing the costs of providing services with in-house staff vs. utilizing a professional service contract. Such costs should only be considered if (a) they would increase as a result of the action, and (b) the added costs would differ depending on which course of action taken.

For instance, if a department had unoccupied space that could be utilized with little or no additional space and utility costs, there would be no need to include this category of expenses in the analysis. Similarly, if additional space and/or utility costs would be incurred at roughly equivalent amounts whether in-house staff positions were added or outside consultants were provided workspace, such costs could again be disregarded for cost comparison purposes.

If a department would need additional space to house additional In-house positions, but could provide more limited workspace for outside consultants, the additional costs of the space and utilities for in-house additions would need to be considered in a comparison of costs.

In the event a service was permanently added to a department's workload and absorbed into existing space and utilities costs, it may be appropriate to apply a proportionate share of these expenses in performing a cost comparison with outside contractual services.

### **Equipment and Furnishings**

Similar to the discussion of added space and utility charges, it may be appropriate to consider the costs incurred for equipment and furnishings when making a decision to provide services with added in-house staff or through utilization of a professional service contract. Once again, such costs should only be considered if (a) they would increase as a result of the action, and (b) the added costs would differ depending on which course of action taken. Also, in the event a service was permanently added to a department's workload and absorbed into existing operations, it may be appropriate to apply a proportionate share of these equipment and furnishings in performing a cost comparison with outside contractual services.

### **Transportation Costs**

In some instances, administrators might need to consider internal transportation costs that employees would incur for business-related transportation costs. These might take the form of cross-charges from the Fleet Management Division for departmental use of County-owned vehicles, or mileage reimbursement for employees using their personal vehicles for County business purposes. Such costs should also be estimated if specified as a reimbursable expense on a professional service contract. It may also be appropriate for administrators to consider whether or not a contractor's hourly rate includes travel time from locations outside Milwaukee County.

### **Other Miscellaneous Costs and Intangibles**

Administrators should always take time to consider any other cost ramifications of choosing between additional County positions or procuring outside resources through a professional service contract. No checklist can include every cost factor that would be relevant for every County department in every circumstance. For instance, there may be differences in the productivity rates between in-house staff and hired contractors. In some cases, the experience and institutional knowledge of in-house staff may give a productivity edge to County workers. In other cases, the specialized expertise and profit motive of the private sector may produce productivity dividends. In many instances, County administrators' experience, judgment and common sense must be applied to weigh such intangibles.

## Example of Documentation Justifying Use of Professional Service Contracting

### Department

Audit

### Scope of Services

The objective of the audit task is to provide the County with the Contractor's report expressing an opinion on the basic financial statements. The Contractor will conduct the County's audit in accordance with U.S. generally accepted auditing standards, the standards for financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States (the "Yellow Book") and the Single Audit Act (i.e., the provisions of OMB Circular A-133, as Revised) and the State Single Audit Guidelines. Accordingly, the Contractor will examine, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assess the accounting principles used and significant estimates made by management and evaluate the overall financial statement presentation.

### Justification for Utilizing Professional Service Contracting

Several factors were considered in the decision to obtain the services of a Certified Public Accounting firm, as opposed to using existing in-house audit staff or hiring additional staff auditors, as noted below. It is the judgment of the Director of Audits that, the non-monetary benefit derived from contracting with a private CPA firm far exceed the potential cost savings obtained from using in-house audit staff to perform the annual financial audit of Milwaukee County's comprehensive financial statements.

### Cost Considerations

Consideration of major cost factors (see attached spreadsheet) indicates contracting for these services costs approximately \$85,000 more annually than using internal staff positions.

### Other Considerations

Non-monetary considerations factored into this decision include the following:

- **Organizational Independence**—Although the Department of Audit reports to the County Board of Supervisors and is independent of the Executive Branch of County government, it is not organizationally independent of the County. Bond rating agencies rely heavily on the independent auditor's opinion letter contained in Milwaukee County's Comprehensive Audited Financial Report (CAFR) when establishing their credit ratings, which affect the County's cost of capital. The added independence and prestige of a large CPA firm is an essential component of retaining the County's AA bond rating.
- **Financial Auditing Workload**—The workload associated with this effort is not evenly distributed throughout the year. Therefore, it would be difficult to recruit and retain sufficient internal staff positions with the requisite financial auditing skills (e.g., CPA certification), as opposed to performance auditing skills, and to keep such individuals productively engaged throughout the year. The County Audit Department does not have a mix of government and private sector businesses, with various fiscal year-end timeframes, as well as tax preparation and other seasonal workloads, to allow for year-round employment of individuals with such skills.

- **Performance Auditing Focus**—Hiring a CPA firm to conduct the annual comprehensive financial audit of Milwaukee County permits the Department of Audit to focus its internal staff resources on performance audits. Performance audits are designed to be value-added reviews of County operations. While also performing some financial-related and compliance audits, focusing internal staff resources on performance auditing provides the Audit Department with a wealth of experience and sound familiarity of County operations, sources of information, and institutional culture. This balance of internal performance auditing focus and external financial auditing expertise positions the Department to successfully pursue its mission statement: *Through independent, objective and timely analysis of information, the Milwaukee County Department of Audit assists both policy makers and program managers in providing high-quality services in a manner that is honest, efficient, effective and accountable to the citizens of Milwaukee County.*

**Example Cost Comparison  
Internal Audit Staff vs.  
Contract with Certified Public Accounting Firm**

**Wage Adjustments for County Positions**

Standard Full-Time Work Year	2,080 Hours
Average Paid Time Off	-330 Hours
Average Work Time	1750 Hours
Adjustment Factor	0.84 (1,750 / 2,080)

**Base Hourly Wage\*****\$29.07**

Adjusted for Paid Time Off	\$34.61 (\$29.07 / 0.84)
Adjusted for Employers' Social Security	<b>\$37.25</b> (\$34.61 x 1.0765)

Active Health Care Hourly Rate ('09 Est.)	\$6.65 (\$13,842 / 2,080)
Adjusted for Paid Time Off	<b>\$7.92</b> (\$6.65 / 0.84)

Active Pension Cost Hourly Rate ('09 Est.)	\$4.23 (\$29.07 x 1454)
Adjusted for Paid Time Off	<b>\$5.03</b> (\$4.23 / 0.84)

**Total Adjusted County Hourly Rate****\$50.21** (\$37.25 + \$7.92 + \$5.03)**Cost Comparison**

	<u>Audit</u>	<u>CPA Firm</u>	
Total Wage & Benefits Cost	\$253,058	\$91.67	Blended Wage Rate
Additional Allocated Costs	\$47,399	4,200	Estimated Hours
<b>Total In-House Service Cost</b>	<b>\$300,457</b>	<b>\$385,014</b>	<b>Total Professional Service Contract Cost</b>

Blended Wage Rate	\$50.21
Estimated Hours	5,040
Total Staff Cost	\$253,058

County Service Charges	\$293,151
Staff Training	\$15,900
Supplies/Equipment	\$6,941
Subtotal	\$315,992
Allocation for Service Effort	15%
Additional Allocated Costs	\$47,399

\*Hourly rates are blended management/staff rates based on past experience.

Source: Internal Costs based on County Executive's Recommended 2009 Budget; contractor data based on 2009 contract rates.