

State of Vermont

Department of Finance & Management
109 State Street, Pavilion Building
Montpelier, VT 05620-0401

[phone] 802-828-2376
[fax] 802-828-2428

Agency of Administration

WHITE PAPER – CONTRACTS FOR SERVICE

PURPOSE: The purpose of this paper is to consider how we categorize, budget and account for 3rd party contracts, and to make recommendations for statutory changes to enable a more efficient and less administratively burdensome contracting system while not increasing risk unacceptably.

CONTRACTS FOR SERVICE - DEFINITION

Historically, contracts have been categorized into 2 major groups – “commodities” and “3rd Party Contracts”. Budget appropriations are categorized by Personal Service, Operating Expense, and Grants [a.k.a. major object codes]. Because the budget appropriations for 3rd Party Contracts are included in the “Personal Service” category along with salaries, payroll taxes, benefits and temporary employees, they have been designated and referred to in statute as “Personal Service Contracts” [3 V.S.A. § 341 (2) and 3 V.S.A. § 311(a)(10)].

The term “Personal Service” contract is not fully representative of all these 3rd Party Contract and causes inappropriate and inconsistent accounting. Using this term also carries with it the perception that most if not all 3rd Party contracts, seek to avoid using classified employees, or may prevent or delay the creation of new permanent classified positions. Commodity contracts are correctly budgeted, appropriated and accounted for as Operating Expenses. Contracts that are 100% for the procurement of good, products, material, etc. can rightfully be referred to as “commodity contracts.” The converse – that all contracts that are not commodity are therefore personal service – is not as clear cut and is not always correct.

We can make the statement that all non-commodity contracts are 3rd Party Contracts or Contracts for Service. But, not all Contracts for Service are Personal Service Contracts. Additionally, when a personal service contract is valued at \$20,000 or more per year for work that is the same or substantially similar to and in lieu of services previously provided, in whole or in part, by permanent, classified state employees, and which result in a reduction in force of at least one permanent, classified employee, or the elimination of a vacant position of an employee covered by a collective bargaining agreement may be termed a “privatization contract.” Privatization contracts (3 VSA sec 341 (3)) are subject to justification criteria, review by the Commissioner of Human Resources, union notification, and approval by the Attorney General and the Secretary of Administration.

Following are several examples that illustrate the differences between types of Contracts for Service vs. Personal Service Contracts.



Example #1: BGS hires a local contractor to plow a small state parking lot over 1 hour away from any other state site. Because state employees currently perform snow removal at other locations and could drive 1 hour and plow this location, this contract **IS** a **PERSONAL SERVICE CONTRACT**. However, it is rightly contracted out because it would not be economically feasible for BGS to send one of their employees and a plow truck on a 2 hour round trip to do a 15 minute plow job for each snowfall.

Example #2: AOT hires an operator and his road grader to re-grade an embankment. Assume that the State does not own this type of equipment and does not have employees who are “road grader operators” – consequently, this contact is a **CONTRACT FOR SERVICE**, but **NOT** a personal service contract.

Example #3: The State Psychiatric Center hires a nursing service to cover nights and weekends. Because the State does have mental health nurses, not only does this qualify as a **PERSONAL SERVICE CONTRACT**, it may also be a **PRIVATIZATION CONTRACT** if even one permanent classified nurse is RIF’s or one vacant nursing position is eliminated as a result of the contract.

Example #4: Oracle Corporation requires that the State sign a contract (Service Level Agreement/License) authorizing the State to install and use the VISION system, and obligating the State to allow only Oracle to service this proprietary software. The State has developers and technical staff who are authorized under the terms of the Oracle License Agreement to perform regular maintenance tasks and limited “fixes” to the production environment. The State, however, is legally prohibited from changing or modifying the proprietary code of the software. Doing so would either void the software warranty, or eliminate the State’s right to use the software, or both. Under current rules, this is considered a **PERSONAL SERVICE CONTRACT**. However, proper accounting should record the expenditures for this contract as Information Technology Operating Expense not personal services, as currently happens in the appropriation bill and accounting system. This contract should be an Operating Expense Contract.

Example #5: The State contracts with a consultant to help manage and act as project manager for the implementation of a major new software application. Because the State (DII) does have project managers and software developers, this **IS** a **PERSONAL SERVICE CONTRACT**. However, it is rightfully contracted out for several reasons: the one-time non-permanent nature of the project; insufficient internal expertise with this application; and the need for knowledge transfer to state employees who will then be able to operate and maintain the application post implementation.

Example #6: The State hires a company to provide secure shredding service (shredding confidential papers). This is a **CONTRACT FOR SERVICE**, NOT a personal service contract because the State does not provide secure shredding performed by employees and would not want custodial employees to have access to pre-shredded confidential documents. As in example #4, proper accounting would records these expenditures as Operating Expense, as is custodial service (included

in FFS), not as Personal Service, as currently happens in the appropriation bill and accounting system.

Example #7: The Defender General (DG) hires outside attorneys to handle variable workload, and to provide separate defense representation for cases with multiple defendants. These contracts are **PERSONAL SERVICE CONTRACTS** because the same work is performed by DG employee attorneys, but they are rightly contracted out because of the inconsistent workload, the each defendant's legal right to separate counsel, and the elimination of the appearance of conflict of interest.

It is clear that our perceptions, attitudes and accounting for non-commodity contracts are neither consistent nor correct. One way that departments have tried to ameliorate the issue is by creating many 3rd Party accounts within personal services such as 3rd Party – Legal; Engineering; Software Development; IT Maintenance, etc. Although this provides more information, the fact remains that all of these Contracts for Service remain in the “Personal Service” section and are some are not appropriately recorded as Operating Expenses. Categorizing all Contracts for Service as Personal Service perpetuates the perception that the State issues more “Personal Service” contracts than it should.

It is the intent of the State that employees be used to perform the work of government whenever feasible. However, incorrectly categorizing and accounting for all non-commodity contracts as “Personal Service contracts” is not the answer. The answer, we propose, is to expand the contract categories to properly reflect what is and is not a Personal Service contract. Adopting this methodology will require changes to existing statutory language, as well as changing how contracts are budgeted and accounted for.

3 V.S.A. §344 requires the Secretary of Administration to provide a list of Privatization Contracts and Personal Service contracts each year. The changes we proposed will enable us to continue to report on all Contracts for Service, but will also categorize them correctly for accounting and budgeting purposes by the categories listed below:

- 1) Professional Service: includes licensed professionals such as lawyers, accountants, architects, engineers, physicians, nurses, mental health providers, etc. Personal Service
- 2) Consulting Services: includes consultants, investment managers, IT Project Managers. Personal Service
- 3) IT Contracts: includes hardware, software, service level agreements, licenses. Personal Service or Operating Expenses.
- 4) Construction: includes building renovation, building construction, bridge construction, transportation contracts. May be capital contracts or Operating Expense.
- 5) Marketing: includes marketing and design work. Personal Service.

- 6) Contract Employees: includes Clerks of the Works, and other contracts which do not pass the A-B-C Test. Personal Service (note: also may be required to be paid through payroll)
- 7) Retirees/Former Employees: includes hire-backs on temporary assignment. Personal Service.
- 8) Financial Transactions: includes banks and web providers who receive money on behalf of the State. Operating Expense.
- 9) Capital Leases: rare and must be carried as Operating Expense or Capital.
- 10) Other: includes contracts for service not included in #1 - #9.
- 11) Privatization: includes personal service contracts valued at \$20,000 (goal is to change to \$25k – see below) or more per year for work that is the same or substantially similar to and in lieu of services previously provided, in whole or in part, by permanent, classified state employees, and which result in a reduction in force of at least one permanent, classified employee, or the elimination of a vacant position of an employee covered by a collective bargaining agreement.

CONTRACT FOR SERVICE THRESHOLDS

Additionally, the Administration also recommends that the statutory contract thresholds be consistent. We recommend setting the Contract for Service, Privatization and Attorney General review thresholds to \$25,000. This is a reasonable amount equal to about 45% of the average classified employee wages, exclusive of benefits, for FY 2014 (\$56k).

Contract for Service: 3 V.S.A. § 341 (2) = \$25,000.00

Privatization Contract: 3 V.S.A. § 341 (3) = \$25,000.00

Attorney General Review: 3 V.S.A. § 311(a)(10) = \$25,000.00

Contract for Service statistics, for FY14 and FY15, show less than 1% of all contract for service dollars come from contracts of \$10k or less. Yet, these same contracts account for 33% - 36% of the number of contracts executed each year (Qty. 550 – 625). The total dollars executed for contract at \$10k or less is \$3 - \$4 million.

Conversely, 70% - 75% of all contracts dollars are from contracts over \$1 million (Qty. 45 - 63). We believe that allowing procurement of services for \$10k or less, without a formal written contract (must have valid insurance certificate) will greatly reduce the burden on staff while keeping risk low (Risk \$3 - \$5 million).

FY 2015 Contracts for Service Stats				
% Number Contracts	# Contracts	Contract Value Range	Total Dollars	% Dollars by Range
0.3%	6	Over \$10 million	155,842,786.00	36.7%
0.3%	6	\$5 million to <\$10 million	38,510,601.21	9.1%
2.6%	51	\$1 million - <\$5 million	106,453,149.69	25.1%
2.1%	41	\$500k - <\$1 million	30,227,837.98	7.1%
3.9%	75	\$250k - <\$500k	24,672,679.46	5.8%
11.3%	220	\$100k - <\$250k	32,425,414.88	7.6%
16.5%	254	\$50k - <\$100k	17,335,192.38	4.1%
19.4%	299	\$20k - <\$50k	9,676,813.74	2.3%
28.2%	435	\$10k - <\$20	6,108,424.96	1.4%
35.9%	554	Under \$10k	3,012,418.23	0.7%
100.0%	1941	Grand Total	424,265,318.53	100.0%
FY 2014 Contracts for Service Stats				
% Number	#	Contract Value Range	Total Dollars	% Dollars by Range
0.3%	6	Over \$10 million	245,852,675.00	51.2%
0.3%	6	\$5 million to <\$10 million	34,126,452.00	7.1%
1.8%	34	\$1 million - <\$5 million	77,684,432.00	16.2%
2.3%	43	\$500k - <\$1 million	29,826,336.00	6.2%
3.9%	74	\$250k - <\$500k	25,360,652.00	5.3%
9.8%	184	\$100k - <\$250k	29,750,356.00	6.2%
12.9%	243	\$50k - <\$100k	18,527,679.00	3.9%
14.3%	270	\$20k - <\$50k	9,109,189.00	1.9%
21.2%	400	\$10k - <\$20	5,878,679.00	1.2%
33.2%	626	Under \$10k	3,611,519.00	0.8%
100.0%	1886	Grand Total	479,727,969.00	100.0%

STATUTORY CHANGES (suggested – not Legislative Counsel final version)

3 V.S.A. § 311. Classified service defined; exceptions

- (a) The classified service to which this chapter shall apply shall include all positions and categories of employment by the state, except as otherwise provided by law, and except the following:

* * *

- (10) A person or persons engaged under retainer, contract, or special agreement, for \$25,000.00 or more, when certified to the secretary of administration by the attorney general that such engagement is not contrary to the spirit and intent of the classification plan and merit system principles and standards provided by this chapter.

3 V.S.A. § 341. Definitions

* * *

(2) "Personal services contract" or "contract" means an agreement or combination or series of agreements, by which an entity or individual who is not a state employee agrees with an agency to provide services, which may rightly be categorized as "Personal" and which are valued at ~~\$10,000.00~~ \$25,000.00 or more per year.

(3) "Privatization contract" means a personal services contract by which an entity or an individual who is not a state employee agrees with an agency to provide services, valued at ~~\$20,000.00~~ \$25,000.000 or more per year, which are the same or substantially similar to and in lieu of services previously provided, in whole or in part, by permanent, classified state employees, and which result in a reduction in force of at least one permanent, classified employee, or the elimination of a vacant position of an employee covered by a collective bargaining agreement. (Added 1999, No. 75 (Adj. Sess.), § 2; amended 2009, No. 54, § 107, eff. June 1, 2009.)

3 V.S.A. § 344. Contract administration

(a) The Secretary of Administration shall maintain a database with information about approved privatization contracts and approved ~~personal services~~ contracts for service, including those categorized as "Personal Services". The Secretary shall also maintain a database with information about privatization contracts which are rejected because they fail to qualify under subdivision 343(2) of this title. Contracts shall be public record to the extent provided under chapter 5 of Title 1, and shall be located at the agency of origin, including information about names of contractors, summaries of work to be performed, costs and duration.