

**Privatization without Competition
equals Huge Losses:**

How the New York State Government Wastes Hundreds of
Millions of Dollars without Increasing Service Quality

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Fiscal Policy Institute

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Privatization without Competition equals Huge Losses:

How the New York State Government Wastes Hundreds of Millions of Dollars without Increasing Service Quality

New York State could save up to \$500 million a year by stopping sweetheart deals with high-priced consultants who are being overpaid to do jobs that state workers can do as well, if not better.

It is indeed ironic that New York State is wasting hundreds of millions of dollars a year through the “contracting out” of professional services work when the very term “privatization” implies that it is a way to reap the benefits of a key element of private sector operations - competition. But in the way that outsourcing works in New York, there is virtually no competition. The result is that in most cases in which New York State contracts out for the performance of professional services, state taxpayers do not get the benefit of reduced costs nor does the state get higher quality work. There are situations in which the state contracts out for professional services that are so specialized that they can not be provided by state employees. But that only accounts for a portion of the state's contracting out for professional services. In the areas reviewed for this study, on the other hand, state employees can do much of the work involved and the state government could save hundreds of millions of dollars by hiring the needed professional employees rather than contracting out.

Based on the analysis presented in this report, New York State should limit its contracting out of professional services to those services that are so specialized and/or that are used by the state so infrequently that it would not make sense on a cost/benefit basis to maintain the capacity to perform those services “in house.”

This study has two primary purposes. First, to identify the amount of money spent by the state government for consultants (or what we will sometimes refer to in this study as professional services contracts or professional services contractors), with a primary emphasis on those consulting services that could be performed as well or better, and at lower cost, by state employees. And, second, to estimate the magnitude of the potential savings to the state government from a cost-effective program of “contracting in.”

Part 1: Estimating the Magnitude of New York’s Spending on Professional Services Consultants

To accomplish the first objective of identifying the amount that the state now spends on consulting services of this type, we rely on various back-up accounting reports produced by the Office of the State Comptroller, particularly two reports commonly referred to by their identifying numbers - FIN 210 and FIN 220. These reports allow us to get a finer breakdown of state expenditures than is available from the state’s annual and monthly financial reports, which divide state expenditures, whether by agency, fund or fund type, into five major categories:

- Local Assistance Grants
- Departmental Operations
- General State Charges
- Debt Service, and
- Capital Projects.

The state's annual and monthly financial reports further divide spending for "Departmental Operations," into two categories - "Personal Service" and "Non-Personal Service." The "Personal Service" category consists, for the most part, of the wages and salaries paid to state employees. This category of spending also includes payments to individuals who perform consulting services for state agencies as independent contractors. But the bulk of the state's expenditures for consultants are included within the "Non-Personal Service" category along with a wide range of other types of expenditures including supplies and materials, moving, travel, rentals and repairs, utilities, postage and shipping, printing, telephone charges, and equipment. Because of requirements of Generally Accepted Accounting Principles as prescribed by the Governmental Accounting Standards Board, some expenditures for consultants paid for with Capital Projects Funds are no longer reported in the state's annual financial reports as Non-Personal Service expenditures. Instead, they are simply included in the total spending reported for capital projects. The state's accounting system and back-up accounting reports, however, allow for the identification of the amount expended for those purposes from state Capital Projects Funds. But not all Capital Projects expenditures are covered by these accounting reports as the following footnote from the "Comptroller's Annual Report to the Legislature on the Cash Basis of Accounting," for the fiscal year ended March 31, 2004, explains:

The State's Capital Projects Financial Plan includes projected capital disbursements financed with (1) appropriated State and Federal cash resources, and (2) State and Public Authority bond proceeds. Also included are off-budget proceeds of public authority bonds issued for such programs as Community Enhancement Facilities Assistance Program (CEFAP), the Centers of Excellence, Gen*NY*sis, Empire Opportunity Fund, and various other economic development programs; the Consolidated Highway Improvement Program (CHIP); certain Department of Mental Hygiene and CUNY higher education capital projects; SUNY Dormitory Facilities and SUNY community colleges. Because these public authority bond proceeds are not appropriated, related disbursements are not reported in the Comptroller's financial reports prepared on a cash-basis of accounting. Off-budget capital spending is subject to a lesser degree of oversight by the Office of the State Comptroller than appropriated capital spending; contracts are not approved by the Comptroller, and payments are not subject to audit prior to disbursement.

There are some other state expenditures that are not processed through the State Comptroller's office. For example, until recently the payments from the so-called "HCRA Pools" (several "pools" of money created by various charges and taxes adopted as part of or in conjunction with the state's Health Care Reform Act) were also "off budget."

Within the constraints of this limitation - that some expenditures do not, or have not until recently, passed through the state accounting system, the back-up accounting reports produced by

that system such as the FIN 210 and the FIN 220, provide a finer breakdown of state expenditures that allow us to estimate, with some precision,¹ the amount of “on budget” state funds that are spent for professional services consulting contracts. The aspect of the state accounting system that allows for such tabulations is the set of “object codes” established by the State Comptroller as part of the state’s “chart of accounts.” The State Comptroller is required by the State Constitution “to prescribe such methods of accounting as are necessary for the performance” of his Constitutional responsibilities (1) to audit all vouchers before payment and all official accounts and (2) to audit the accrual and collection of all revenues and receipts. An important aspect of the accounting system prescribed by the State Comptroller (and of governmental and business accounting systems generally) is a set of “object codes” that serve to identify different kinds of assets, liabilities, revenues and expenditures. The New York State accounting system’s object codes are grouped into seven categories as described in Table 1.

Table 1: Overall Structure of New York State’s Accounting System Object Codes

Object Codes Beginning with	Type of Asset, Liability, Revenue or Expenditure
1	Assets
2	Liabilities
3	Revenues
4	Personal Service Expenditures
5	Non-Personal Service Expenditures
6	Grant Expenditures
7	Capital Construction Expenditures

Every expenditure processed for payment through the state accounting system is assigned a 5-digit object code beginning with a 1, 2, 3, 4, 5, 6, or 7. For the most part, the first 4 digits of each object code are prescribed by the State Comptroller for which his office provides descriptions and examples to ensure continuity and comparability among the various state agencies.² If the Governor or the Budget Division or a legislative committee are to be able to examine, for example, how much the state is spending for fuel oil and how those expenditures have changed over time, it is essential that all state agencies assign the same object code to the payments that they make for fuel oil.

¹ We cannot do this with complete precision because of the tendency of some state agencies to code some expenditures as being for “other services” even when the state accounting system provides a more precise code for the expenditures involved.

² Each state agency is able to use the fifth digit in an object code if it wishes to track some subcategory of the spending included in the 4-digit category as established and defined by the State Comptroller.

Within the Non-Personal Service Expenditures category (the object codes beginning with the number 5), the expenditures for most of the kinds of professional services of relevance to this study fall within a subcategory of object codes beginning with the numbers 56 and referred to as Contractual Services. This Contractual Services subcategory also includes many kinds of services that are not of relevance to this study.

The 56XXX “object codes” examined for this study, and their descriptions from the State Comptroller’s *Accounting Codes Manual* (Volume VIII of the *New York State Accounting System User Procedures Manual*), are listed in Table 2. Some of these object codes, such as Object Code 5620 - Information Technology Consultants, consist entirely of professional consulting services of the type covered by this study. Others, however, include expenditures for professional services consultants as well as expenditures for purposes not of relevance to this study. An example of this latter grouping is Object Code 5640 which includes fees for state employees to attend conferences as well as payments to consultants to conduct training sessions for state employees. While savings might be obtained from a cost-benefit based approach to “contracting in” in regard to the professional services activities covered by this object code, we have not estimated those potential savings because of the “mixed” nature of the expenditures involved. For this and other reasons, discussed at other points in this report, we believe that the overall savings estimates presented in this report’s concluding section understate the magnitude of the potential savings that the state government could realize from objective comparisons of the cost of “in house” and “outside” provision of professional services to state agencies.

As indicated above, payments to consultants from Capital Projects Funds are not reported in the state’s annual financial reports as Non-Personal Service Expenditures because of requirements of Generally Accepted Accounting Principles as prescribed by the Governmental Accounting Standards Board. The state’s accounting system and back-up accounting reports, however, allow for the identification of the amounts paid to consultants from Capital Projects Funds. Table 3 lists the object codes within the 7XXXX Capital Construction Expenditures category that cover expenditures for the kinds of professional services of relevance to this study.

Table 2: Non-Personal Service Expenditures Object Codes Covering Professional Services Consulting Contracts

Object Code	Definition/Use	Examples/Comments
5620X	IT Consultant - Design/Develop	Consultant costs for design, development, testing and implementation of customized computer systems
5624X	IT Software Installation/Integration	Consultant costs to install software and/or interface software with existing applications, costs to customize software packages
5626X	IT Software Maintenance	Software maintenance/support agreements
5628X	IT Hardware Maintenance	Hardware maintenance/support agreements
5629X	IT Services - Other	IT training, IT time-sharing services
5631X	Accounting & Auditing Services	Bookkeepers, accountants and auditors
5632X	Legal Services	Attorney, paralegal, hearing officers
5633X	Medical/Clinical Services	Doctors, nurses, pharmacists, dentists, dietitians, medical and health research, veterinarians
5634X	Client Services	Non-medical services including employment services and education services, and furlough expenses
5640X	Conferences/Training Services	Registration fees for conferences, training sessions. For training related to information technology use 5629X
5699X	Other Services	Services not otherwise classified such as teachers, exam administrators, religious services

Table 3: Capital Construction Expenditures Object Codes Covering Professional Services Consulting Contracts

Object Code	Description
71090	Capital Projects - Consultant Services - Architects - State Projects
71100	Capital Projects - Consultant Services - Engineers - State Projects
71105	Capital Projects - Consultant Services - Bridge Inspection
71110	Capital Projects - Consultant Services - Engineering Supervision
71115	Capital Projects - Consultant Services - Material Testing
71120	Capital Projects - Consultant Services - Other
72340	Other Capital Projects Consultant Services - Local and Public Authority Projects

Based on the information available from the FIN 210 and FIN 220 reports, Tables 4, 4a and 4b present a summary of state expenditures for these professional services categories over the course of the last four state fiscal years. Table 4a presents the expenditures for the seven object codes covering engineering, architectural and related professional services for capital construction projects. Table 4b does the same for the five object codes covering expenditures information technology consultants. The totals from tables 4a and 4b are included as lines in Table 4 along with the expenditures covered by the six other object codes examined as part of this study.

Tables 5, 5a and 5b present the change in spending for these categories of professional services consultants between 2001-02 and 2003-04. As Table 5a indicates, over this three year period, from the 2001-02 state fiscal year to the 2004-05 state fiscal year, state spending for information technology consultants increased by \$111 million, from \$233 million to \$344 million. For the three categories of information technology consulting services for which savings are estimated in Part 2 of this report, spending increased by \$85.6 million (or 64%) over this three year period, from \$134.2 million to \$219.8. (See Figure 1). The second largest increase (in dollars) was in spending for engineers and other capital projects consultants - up \$48 million from \$263 million to \$311 million. It should be remembered, however, that not all of the state's capital plan expenditures are covered by the reports available from the state accounting system.

Table 4: New York State Spending for Selected Categories of Professional Services, 2001-02 through 2004-05

<u>Expenditure Types</u>	<u>2001-02</u>	<u>2002-03</u>	<u>2003-04</u>	<u>2004-05</u>	<u>4-Year Total</u>
Information Technology Consultants (See Table 4a for a breakdown of this category)	\$233,124,227	\$322,313,028	\$320,626,559	\$344,513,910	\$1,220,577,724
Accounting and Auditing Services	\$6,985,754	\$7,995,094	\$7,301,501	\$8,328,965	\$30,611,315
Legal Services	\$78,581,923	\$87,546,877	\$95,587,995	\$118,241,992	\$379,958,787
Medical/Clinical Services	\$126,530,054	\$102,697,566	\$132,093,618	\$157,181,538	\$518,502,775
Non-Medical Client Services	\$68,165,357	\$70,342,210	\$84,711,218	\$90,902,287	\$314,121,071
Conferences and Training Services	\$60,072,173	\$70,264,960	\$68,040,132	\$70,936,216	\$269,313,480
Other Services	\$1,500,700,760	\$1,548,109,016	\$1,555,788,504	\$1,531,203,019	\$6,135,801,299
Capital Projects Consultant Services (See Table 4b for a breakdown of this category)	\$262,762,406	\$270,206,187	\$265,348,310	\$310,550,591	\$1,108,867,494
Total	\$2,336,922,653	\$2,479,474,937	\$2,529,497,837	\$2,631,858,518	\$9,977,753,945

**Table 4a: New York State Spending for Information Technology Consultants,
2001-02 through 2004-05**

Expenditure Types	<u>2001-02</u>	<u>2002-03</u>	<u>2003-04</u>	<u>2004-05</u>	<u>4-Year Total</u>
Information Technology Consultants (Consultant costs for the design, development, testing and implementation of customized computer systems)	\$91,185,555	\$124,533,866	\$133,134,718	\$161,707,006	\$510,561,146
Information Technology Software Installation/ Integration (Consultant costs to install software and/or interface software with existing applications, costs to customize software packages)	\$17,184,171	\$21,176,763	\$20,895,538	\$11,569,034	\$70,825,505
Information Technology Software Maintenance (Software maintenance/ support agreements)	\$25,854,315	\$31,964,309	\$36,722,048	\$46,559,186	\$141,099,858
Subtotal - Above Three Categories	\$134,224,040	\$177,674,938	\$190,752,304	\$219,835,226	\$722,486,509
Information Technology Hardware Maintenance (Hardware maintenance/ support agreements)	\$23,700,199	\$29,133,672	\$28,304,060	\$32,778,960	\$113,916,891
Other Information Technology Services (includes training, and time-sharing services)	\$75,199,988	\$115,504,418	\$101,570,196	\$91,899,724	\$384,174,325
Total	\$233,124,227	\$322,313,028	\$320,626,559	\$344,513,910	\$1,220,577,724

Table 4b: New York State Spending for Capital Projects Consultant Services, 2001-02 through 2004-05

<u>Expenditure Types</u>	<u>2001-02</u>	<u>2002-03</u>	<u>2003-04</u>	<u>2004-05</u>	<u>4-Year Total</u>
Architectural Consultant Services - State Projects	\$25,658,497	\$22,363,468	\$27,435,440	\$26,240,104	\$101,697,511
Engineering Consultant Services - State Projects	\$127,776,493	\$121,384,642	\$128,234,612	\$143,568,040	\$520,963,787
Bridge Inspection Consultant Services	\$10,915,321	\$23,542,051	\$19,240,843	\$27,118,369	\$80,816,583
Engineering Supervision Consultant Services	\$56,057,395	\$55,971,447	\$61,014,980	\$71,341,696	\$244,385,518
Material Testing Consultant Services	\$6,898,137	\$8,213,828	\$7,127,667	\$7,842,079	\$30,081,710
Other Capital Projects Consultant Services	\$35,456,564	\$38,730,750	\$22,294,769	\$34,440,303	\$130,922,386
Total	\$262,762,406	\$270,206,187	\$265,348,310	\$310,550,591	\$1,108,867,494

Table 5: Change from 2001-02 to 2004-05 in Spending for Selected Categories of Professional Services

<u>Expenditure Types</u>	<u>2001-02 Disbursements</u>	<u>2004-05 Disbursements</u>	<u>Change from 2001-02 to 2004-05</u>	
			<u>\$ Change</u>	<u>% Change</u>
Information Technology Consultants (See Table 5a for a breakdown of this category)	\$233,124,227	\$344,513,910	\$111,389,683	48%
Accounting and Auditing Services	\$6,985,754	\$8,328,965	\$1,343,211	19%
Legal Services	\$78,581,923	\$118,241,992	\$39,660,069	50%
Medical/Clinical Services	\$126,530,054	\$157,181,538	\$30,651,484	24%
Non-Medical Client Services	\$68,165,357	\$90,902,287	\$22,736,930	33%
Conferences and Training Services	\$60,072,173	\$70,936,216	\$10,864,043	18%
Other Services	\$1,500,700,760	\$1,531,203,019	\$30,502,259	2%
Capital Projects Consultant Services (See Table 5b for a breakdown of this category)	\$262,762,406	\$310,550,591	\$47,788,185	18%
Total	\$2,336,922,653	\$2,631,858,518	\$294,935,864	13%

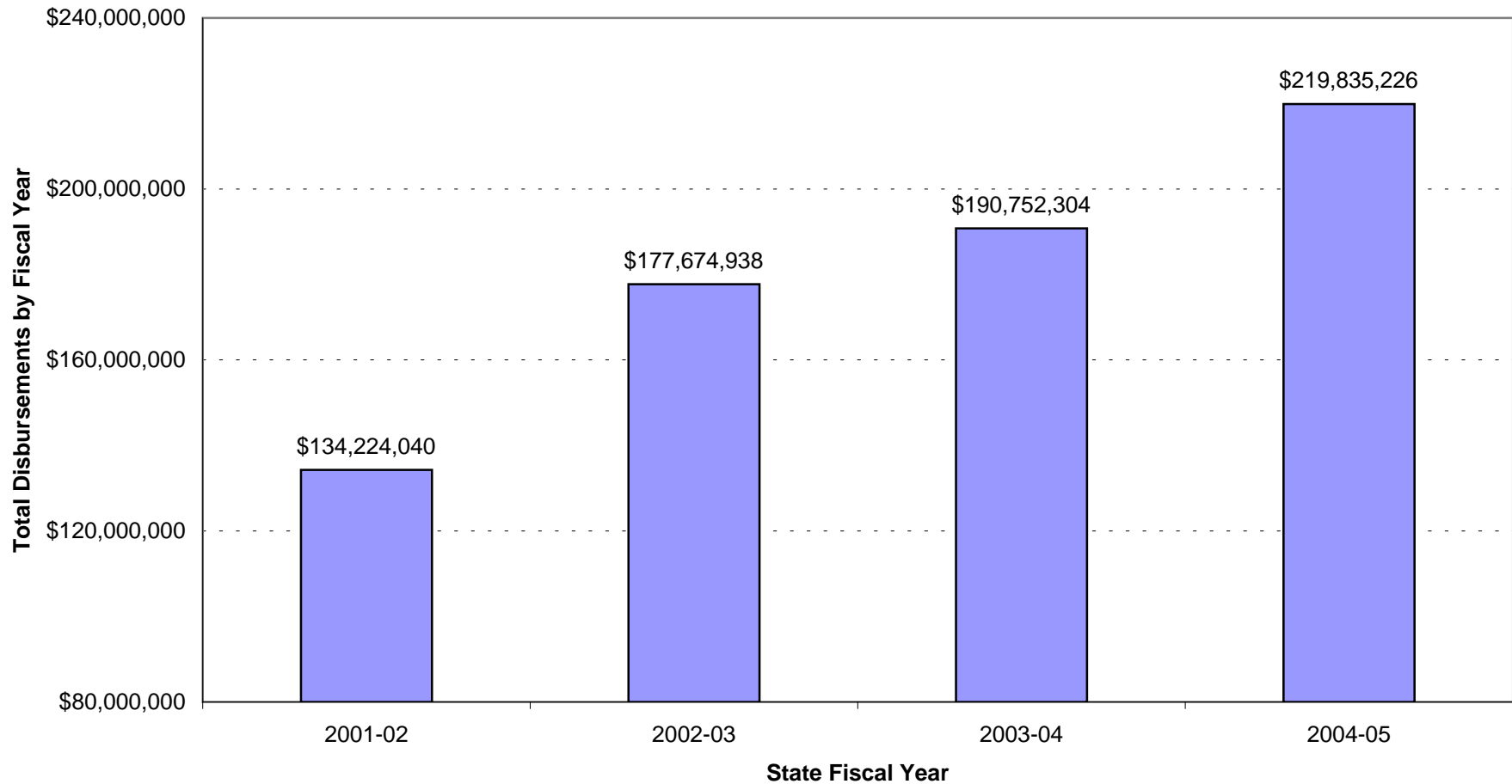
Table 5a: Change from 2001-0 to 2004-05 in Spending for Information Technology Consultants

<u>Expenditure Types</u>	<u>2001-02 Disbursements</u>	<u>2004-05 Disbursements</u>	<u>Change from 2001-02 to 2004-05</u>	
			<u>\$ Change</u>	<u>% Change</u>
Information Technology Consultants (Consultant costs for the design, development, testing and implementation of customized computer systems)	\$91,185,555	\$161,707,006	\$70,521,451	77%
Information Technology Software Installation/ Integration (Consultant costs to install software and/or interface software with existing applications, costs to customize software packages)	\$17,184,171	\$11,569,034	-\$5,615,137	-33%
Information Technology Software Maintenance (Software maintenance/ support agreements)	\$25,854,315	\$46,559,186	\$20,704,871	80%
Subtotal - Above Three Categories	\$134,224,040	\$219,835,226	\$85,611,185	64%
Information Technology Hardware Maintenance (Hardware maintenance/ support agreements)	\$23,700,199	\$32,778,960	\$9,078,761	38%
Other Information Technology Services (includes training, and time-sharing services)	\$75,199,988	\$91,899,724	\$16,699,737	22%
Total	\$233,124,227	\$344,513,910	\$111,389,683	48%

Table 5b: Change from 2001-02 to 2004-05 in Spending for Consultant Engineers and Other Capital Projects Professional Services Consultants

<u>Expenditure Types</u>	<u>2001-02 Disbursements</u>	<u>2004-05 Disbursements</u>	<u>Change from 2001-02 to 2004-05</u>	
			<u>\$ Change</u>	<u>% Change</u>
Architectural Consultant Services - State Projects	\$25,658,497	\$26,240,104	\$581,607	2%
Engineering Consultant Services - State Projects	\$127,776,493	\$143,568,040	\$15,791,548	12%
Bridge Inspection Consultant Services	\$10,915,321	\$27,118,369	\$16,203,047	148%
Engineering Supervision Consultant Services	\$56,057,395	\$71,341,696	\$15,284,302	27%
Material Testing Consultant Services	\$6,898,137	\$7,842,079	\$943,942	14%
Other Capital Projects Consultant Services	\$35,456,564	\$34,440,303	-\$1,016,261	-3%
Total	\$262,762,406	\$310,550,591	\$47,788,185	18%

Figure 1: State Spending For Information Technology Professional Services **not** Including Hardware Maintenance, Training and Time Sharing



Part 2: Estimating the Savings That New York State Could Realize by Using State Employees to do More of the Work Now Done by Professional Services Consultants

A. Consultant Engineers and Other Capital Projects Professional Services Consultants

In 2004-05, New York State spent over \$300 million of Capital Projects funds on engineering, architectural, and other professional services consulting services. As Tables 4 and 4b indicate, \$310.55 million in payments for these purposes were processed through the regular state bill paying process and are accounted for in the Comptroller's cash-basis financial reports. The actual amount spent for Capital Projects consulting services could be substantially greater than this amount since the Comptroller's financial reports do not cover the off-budget proceeds of public authority bonds issued for a variety of purposes including certain Department of Mental Hygiene, CUNY and SUNY capital projects.

In estimating the cost savings that New York State could realize if it used state employees to do this work, we relied on the findings of a study completed in 2000 by the international accounting firm KPMG under a contract let by the New York State Department of Transportation (DOT). This study, which was undertaken in part to verify the findings of earlier reports by State Comptrollers Edward V. Regan and H. Carl McCall, used a state-of-the-art activity based costing analysis to compare the costs of DOT in-house engineers versus consulting engineers and is the most comprehensive study available on the subject. *The KPMG study found that for design work "consultants are approximately 75% more costly than in-house design resources." (i.e., state employees). In regard to construction inspection work KPMG found that "consultants are approximately 50% more expensive than the cost of in-house inspection resources."*

While the KPMG report included these findings on the differences between in-house costs and consultant costs for comparable projects, it did not include an attempt to estimate the overall savings that the state might realize from doing more of this work in-house. As indicated above, however, one of the main purposes of our study is to estimate the magnitude of the potential savings to the state government from a cost-effective program of "contracting in." To make such estimates in regard to this category of consultant spending, we applied KPMG's cost differential factors to the spending reporting by the state accounting system for the capital projects professional services object codes discussed earlier in this report. Some of these object codes are clearly for design work, and others are for inspection work. But for others the mix of design and inspection work is not clear.

As Table 6 indicates, we applied the KPMG finding of a 75% cost difference figure for design work to the state expenditures for architectural services on state projects (Object Code 71090) and its finding of a 50% cost difference figure for construction inspection work to the state expenditures for bridge inspections (Object Code 71105). For the other five categories, we utilized a cost difference factor of 62.5% (the average of the findings in the KPMG study). This probably results in an underestimate of potential savings, particularly in regard to the largest of the categories, engineering consulting services on state projects. For the years examined by KPMG (excluding one year of extremely high expenditures on design consultants in anticipation of a substantial increase in the size of its capital program), spending on design consultants as a

percentage of the spending on design and construction inspection consultants combined ranged from 56% to 75% with an average of 63.7% and a median of 65.3%.

Based on these assumptions, as summarized in Table 6, we estimate that New York State could have saved \$119 million in 2004-05 if it had utilized state employees rather than consultants to do this work. The total potential savings to the state of doing more of its capital projects engineering work-in house is probably greater than this figure since this analysis only applies to consultant costs associated with the portion of the state’s Capital Projects spending that is accounted for in the Comptroller’s cash-basis financial reports.

Table 6

Potential Savings from Replacing Capital Projects Consultants with State Employees (based on State Fiscal Year 2004-05 Disbursements)

Expenditure Types (with Consultant Cost Factor in Parentheses)	Actual Consultant Costs	Estimated State Employee Costs to Complete Same Work	Estimated Savings
Architectural Consulting Service - State Projects (1.75)	\$26,240,104	\$14,994,345	\$11,245,759
Engineering Consulting Services - State Projects (1.625)	143,568,040	88,349,563	55,218,477
Bridge Inspection Consultant Services (1.5)	27,118,368	18,078,912	9,039,456
Engineering Supervision Consultant Services (1.625)	71,341,696	43,902,582	27,439,114
Material Testing Consultant Services (1.625)	7,842,079	4,825,895	3,016,184
Other Capital Projects Consultant Services (1.625)	35,456,564	21,194,032	13,246,270
TOTAL	\$310,550,589	\$191,345,329	\$119,205,260

B. Computer Consultants

In estimating the savings that New York could realize if it used state employees to do more of the computer programming work that it currently contracts out, we did not attempt to estimate any potential savings in regard to the expenditures for Object Code 5626 “Information Technology Hardware Maintenance.” We suspect that a good deal of the spending involved in

this category is related to maintenance contracts to which the state is committed in conjunction with equipment purchases. In estimating the savings that New York State could realize if it used state employees to do more of the computer programming and related work covered by the other four object codes examined, we assume that state employees could ultimately take over all of the work covered by object code 5620X but that some of the work covered by the other three object codes (5624X, 5626X and 5629X) might involve specialized expertise related to commercial software being purchased by state agencies. While state employees may ultimately be able to take over most of this work, the savings estimated below for categories 5624X and 5626X are based on the assumption that half of this work would continue to be contracted out. For category 5629X, "Information Technology Services - Other," we estimated what the savings would be if the state contracted in between 25% and 50% of this work. The bulk of the spending in this category is for computer training, much but not all of which could be contracted in, and the State Comptroller's *Accounting Codes Manual* indicates that this category might also include some expenditures for time-sharing services.

In 2004-05, the four types of information technology (IT) consulting services that we examined accounted for state spending of \$312 million as follows:

- \$161.7 million for the IT consultant design and development work covered by Object Code 5620X which includes the design, development, testing and implementation of customized computer systems. This object code represents the largest component of the state's IT consulting expenditures, growing from 39% of total IT consultant spending in 2001-02 to 47% in 2004-05. This involved a \$70 million (or 77%) increase from \$91.2 million in 2004-05 to \$161.7 million in 2004-05.
- \$11.6 million for the IT software installation and integration work covered by Object Code 5624X which includes the installation of software, the interfacing of software with existing applications, and the customization of software packages. Spending for this category of consultant services declined from \$17.2 million to \$11.6 million between 2001-02 and 2004-05.
- \$46.6 million for the IT software maintenance work covered by Object Code 5626X. Spending for this category of IT spending grew faster (80%) than did spending for any of the other IT professional services object codes.
- \$41.9 million for the IT training and other IT services not covered by the other more specific IT consulting services object codes.

In order to estimate the difference between state computer programmers' compensation (including fringe benefits) and the rates being paid to the firms receiving IT consultant contracts (which in all likelihood are much more than those firms' employees are being paid), we utilized the information available on the Office of General Services (OGS) website regarding approved backdrop contracts for Information Technology Services. These contracts include not-to-exceed hourly rates for 12 classifications of expertise and experience.

The OGS website lists 136 contractors in areas related to application development and systems management for Mainframe (IBM and UNISYS), Mid-Range (AS400, UNIX, DEC and SUN) and PC (Windows, Netware, OS/2, and HP) environments. The average backdrop contract not-to-exceed hourly rate for all 136 contractors in all 12 job classifications/titles is \$213.90 and the median hourly rate is \$208.

The state employees who are in comparable IT positions are either Management Confidential (MC) employees or Professional, Scientific & Technical (PS&T) bargaining unit employees represented by the Public Employees Federation (PEF), with about 7.5% being MC employees and the other 92.5% PS&T/PEF employees. While some of these employees are part-time, the overwhelming majority are full-time annual employees. Thus, for the purposes of this analysis, we took a weighted average of the salaries of the full-time PS&T PEF IT workers and the salaries of the full-time MC IT workers.

The average hourly rate for the 3,348 full-time annual PS&T/PEF IT workers on the January 5, 2005, PEF Master File, based on these employees' salaries as reported, plus a 41% fringe benefit factor was \$39.92. The average hourly rate of 166 MC IT workers, with grades higher than the PS&T/PEF IT workers, based on the New York State Department of Civil Service's April 5, 2005 Composite Report, was \$69.73. The weighted average of these PS&T/PEF and MC hourly rates is \$41.32.

This rate somewhat overstates the true average salary of the state's IT employees for three reasons. First, for the MC employees we used the highest possible salaries for the positions involved (the so-called "job rate") since we did not have information on their actual salaries. Second, excluding the MC employees at salary grade levels equivalent to those of the PS&T/PEF IT workers makes the weighted average hourly rate for state employees higher than it would be otherwise. And, third, we did not include the salaries of part-time employees in this computation.

Even with these overstatements of the hourly rate, with fringe benefits, of state IT employees, there is an enormous difference between the cost of state employees and the amount that the state is paying to consulting firms for their employees' IT efforts on behalf of state agencies. Specifically, the overstated average state IT employee hourly rate of \$41.32 is only 19.3% of the consulting firms' average hourly rate of \$213.90. This means that the state is spending five times more for these professional services than it would be spending if it increased the state IT workforce and did more of this work in-house.

By applying this rate differential to all of the expenditures covered by Object Code 5620X and to half of the work covered by Object Codes 5624X and 5626X, as summarized in Table 7, we estimate that if this alternative policy had been in effect during the 2004-05 state fiscal year that the state government would have saved between \$172 and \$190 million.

Table 7

Potential Savings from Replacing Information Technology Consultants with State Employees (based on State Fiscal Year 2004-05 Disbursements)

Expenditure Types (with Estimated Percent of Work to Be Done In-House in Parentheses)	Actual Consultant Cost	Estimated Costs with State Employees Doing Specified Percentage of Work	Estimated Savings
Information Technology Consultant – Design/Develop (100%)	\$161,707,006	\$31,237,651	\$130,469,356
Software Installation/Integration (50%)	\$11,569,034	\$6,901,937	\$4,667,096
Software Maintenance (50%)	\$46,559,186	\$27,776,614	\$18,782,572
Other Information Technology Services (25% to 50%)	\$91,899,724	\$54,826,198 to \$73,362,961	\$18,536,763 to \$37,073,526
Total	\$311,734,950	\$120,742,400 to \$139,279,163	\$172,455,787 to \$190,992,550

C. Legal Services

In 2004-05, New York State spent \$118 million for “Legal Services” consulting contracts. In estimating the difference between state lawyers’ compensation (including fringe benefits) and the rates being paid to the firms receiving legal services contracts from the state, we utilized the information available on the Office of General Services (OGS) website regarding approved backdrop contracts for legal services.

The OGS website lists 3 backdrop contracts in this field (Award Number 00875, Group 73003 - Temporary Personnel) with the following hourly rates for Lot 1- Professional, Technical and Managerial Occupations, Item 5 - Lawyers: New York City (\$78.19), Hudson Valley (\$91.02) and the Capital Region (\$57.48). The average of these three rates is \$75.56.

The average hourly rate for the 955 full-time, annual salaried PS&T/PEF lawyers on the January 5, 2005, PEF Master File, based on their annual salaries as reported, plus a 41% fringe

benefit factor, was \$50.42. This is approximately 66.7% of the average hourly rate available through the backdrop legal services contracts. Applying this rate differential to the expenditures covered by Object Code 5632X Legal Services, we estimate that if the state government had done all of its legal services in house in 2004-05 it would have saved \$39.3 million. If it had contracted out only half as much of its legal services work as it did, with the other half being done in-house, it would have saved an estimated \$19.7 million.

D. Accounting and Auditing Services

In 2004-05, New York State spent \$8.3 million for “Accounting and Auditing” consulting contracts. In endeavoring to estimate estimating the savings that could be achieved by doing more of this work in-house, we compared the compensation of state accountants and auditors, including fringe benefits, with the rates set in the approved backdrop contracts for accounting and auditing services on the Office of General Services (OGS) website.

The OGS website lists 18 backdrop contracts in this field (Lot 1 - Financial and Financial -Related Audit) as part of Award 939, Group 79037 Audit Services - Statewide. We utilized the rates for the three contractors who are approved to do Lot 1 work in all of the regions into which the state is divided for the purposes of this contract and found that the median level Accountant/Auditor position had an average not-to-exceed hourly rate of \$124.33.

The average hourly rate for the 2,901 full-time annual salaried PS&T/PEF accountants/ auditors, on the January 5, 2005, PEF Master File, based their annual salaries as reported in that file, plus a 41% fringe benefit factor, was \$37.98. This is approximately 30.5% of the average of the hourly rates for the median level Accountant/Auditor positions on the three backdrop contracts approved for all six regions of the state. Applying this rate differential to the spending covered by Object Code 5631X Accounting and Auditing Services, we estimate that if the state government had done all of this work in-house during 2004-05 it would have saved \$5.8 million. If it had contracted out only have as much of its accounting and auditing work as it actually did, with the other half being done in-house, it would have saved an estimated \$2.9 million.

E. Medical and Clinical Services

During the 2004-05 state fiscal year, New York State spent approximately \$157 million contracting out for medical and clinical services. Based on the actual salaries of 8,859 full-time annual salaried professionals in these fields from the January 5, 2005, PEF Master File, the average hourly rates for these occupations, including 41% for fringe benefits, are \$66.80 for 100 dentists , \$75.50 for 926 doctors including psychiatrists, \$38.72 for 7,633 nurses (which includes the impact of the geographic differential that PEF nurses are paid) and \$37. 24 for 200 pharmacists. The weighted average hourly rate of these professionals, including the 41% fringe benefit factor, is \$43.30.

A comparison hourly rate for the contractors in these fields was calculated based on the rates for these professions under the OGS Backdrop Contract for Temporary Personnel (Award 00875, Group 73003) using all of the contractors approved to provide these services and their approved rates. The average hourly rates involved are \$79.14 for dentists, \$122.17 for doctors

including psychiatrists, \$51.63 for nurses and \$67.18 for pharmacists. The weighted average hourly rate of these professionals is \$60.52, which is 1.39 times the weighted average hourly rate for state employees in these fields.

Applying this rate differential to the expenditures covered by Object Code 5633X Medical/Clinical Services, we estimate that if the state government had done all of this work in-house during 2004-05 it would have saved approximately \$44.7 million. If it had contracted out only half as much of this work as it actually did, with the other half being done in-house, it would have saved an estimated \$22.4 million.

F. Other Services

The “Other Services” Object Code (5699X) is supposed to cover those contractual services expenditures not covered by the 21 more specific object codes for various kinds of contractual services established by the State Comptroller. From the examples and comments provided in the state’s *Accounting Codes Manual* (Volume VIII of the *New York State Accounting System User Procedures Manual*), it seems that this object code was intended to apply to a relatively modest amount of state expenditures. According to the *Accounting Codes Manual*, this object code is supposed to be used for “Services not otherwise classified such as teachers, exam administrators, religious services.”

But from a review of the contract descriptions for the contracts pursuant to which Object Code 5699X expenditures were made during ten of the past 12 months,³ it is clear that New York State does not spend \$1.5 billion a year on “teachers, exam administrators, and religious services.” Instead, the magnitude of expenditures attributed to Object Code 5699X appears to be, in part, attributable to incorrect object coding by the agencies involved. In fact, the expenditures processed with this object code included expenditures for the various types of professional services consulting contracts examined earlier in this study (accounting and auditing, engineering services, information technology consulting, legal services, and medical and clinical services).

To estimate the amount spent for these purposes, we calculated the expenditures pursuant to contracts with Contract Category Codes applicable to those purposes and applicable to all state agencies.⁴ We also identified the IT consulting contracts included within a more general “temporary personnel” contract category code. The result of these calculations was that accounting and auditing and information technology consulting both accounted for about 2% of the \$1.389 billion of expenditures involved, engineering services for 1.3%, legal services for .04%, and medical and clinical services for 4.5%. These percentages were then applied to the \$1.531 billion in other services disbursements for the full year as reported above in Table 4. To estimate the savings that might be realized in each of these component areas, we applied the cost factors developed in conjunction with the analysis of the relevant applicable categories in the

³ These expenditures represented \$1.389 billion of the fiscal year total of \$1.531 billion.

⁴ In other words, we did not include in our analysis any “agency specific” contract category codes for any of these purposes. As a result of this exclusion we are underestimating the magnitude of the relevant expenditures.

earlier sections of this study. The result is that the state government could have saved between \$54 and \$73 million in 2004-05 if it had in place a cost-effective approach to “contracting in” in relation to the provision of just this small portion (\$151 million of \$1.53 billion) of its Object Code 5699X expenditures. With even a modest savings of 4% to 6% in the rest of this category, these savings would be doubled to between \$100 and \$150 million.

Conclusion and Recommendations

Based on the analysis presented in this report, New York State should undertake an aggressive and cost-effective program of “contracting in.” In the areas reviewed, with relatively conservative assumptions, we estimate that the state government could save between \$390 million and \$474 million per year. And these estimates do not include any potential savings from the over \$1.38 billion in expenditures in the “Other Services” category that we were not able to attribute to one or another of the five areas of contractual services analyzed in this study.

Table 8
Summary of Potential Savings of Having State Employees do More of
the Work now Contracted Out to Consultants
Based on State Fiscal Year 2004-05 Disbursements, with Portions of
“Other” Services Expenditures Allocated to Appropriate Categories.
Not Including Any Potential Savings from Unallocated Portion of
“Other” Services Category

Expenditure Types	Potential Savings - Low Estimate	Potential Savings - High Estimate
Information Technology Consultants	\$198.3 Million	\$216.8 Million
Accounting and Auditing Services	\$12.9 Million	\$25.9 Million
Legal Services	\$19.8 Million	\$39.6 Million
Medical/Clinical Services	\$32.1 Million	\$64.2 Million
Capital Projects Consultant Services	\$127.1 Million	\$127.1 Million
Total	\$390.2 Million	\$473.5 Million

With even modest savings in the areas of professional services contracting out that were not analyzed in this study, New York State could easily save up to \$500 million a year by increasing the state's workforce in the fields involved and reducing cost-ineffective contracting out.

This conclusion, however, should not come as a surprise to state policymakers. Fifteen years ago, in May 1990, in issuing an audit report on the *Department of Transportation: Use of Consultant Engineers* (Report 89-S-45), State Comptroller Edward V. Regan said that "The State Department of Transportation could save millions of dollars by reducing its reliance on outside engineering services for design, supervision and inspection and, instead, increasing its own engineering staff."

But over the years, the situation has gotten worse rather than better. In 1998 and 2001, Regan's successor as State Comptroller, H. Carl McCall, issued reports on the same subject with similar conclusions. And, as referenced earlier in this report, the Department of Transportation's own consultant KPMG concluded that consulting engineers were 75% more costly for design work and 50% more costly for inspection work.

In issuing his reports in 1998 and 2001, besides calling for more contracting in, McCall also recommended that the state only use consultant engineers when they are proven to be most efficient. Such use of cost-benefit analysis is something the state should definitely pursue in all of its areas of cost-ineffective contracting out. But in the short run, the state government should begin to reverse the staff reductions that have frequently been used as the justification for having to contract out and for having to do so at rates that are much higher than the comparable in-house costs.