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FISCAL IMPACT REPORT

SPONSOR HGUAC DATE TYPED 3/2/05 HB 283/HGUACS
 SHORT TITLE Performance Contracting Act SB _____
 ANALYST Hadwiger

APPROPRIATION (in \$000s)

| Appropriation Contained | | Estimated Additional Impact | | Recurring or Non-Rec | Fund Affected |
|-------------------------|------|-----------------------------|-------|----------------------|------------------------------|
| FY05 | FY06 | FY05 | FY06 | | |
| | | | \$0.1 | Recurring | General Fund/ Other funds |

(Parenthesis () Indicate Expenditure Decreases)
 Companion to SB330.

SOURCES OF INFORMATION

LFC Files

Responses Received From

Public Education Department (PED)
 Department of Health (DOH)
 Corrections Department (CD)
 Human Services Department (HSD)
 Attorney General (AG)
 State Auditor

No comments were received from the Department of Finance and Administration at the time this FIR was prepared.

SUMMARY

Synopsis of HGUAC Substitute

The House Government and Urban Affairs Committee Substitute for House Bill 283 would enact the "Contract Management Act." This act would apply to contracts for professional and consulting services, including contract management, construction, construction contract management, construction manager at-risk and information technology.

The substitute would require agencies to objectively evaluate the need for a contract prior to making a decision to contract to assess 1) whether the agency has the necessary skills to deliver the service, 2) whether the service would duplicate similar services already provided by the agency in the same geographic area and 3) whether there are deadline requirements that an agency may not be able to meet. The agency's administrative services division, general counsel

and cabinet secretary (or equivalent personnel for noncabinet agencies) would be required to substantively review the decision to contract, request for proposal process, final contract negotiations and contract form and legal sufficiency.

The substitute would prohibit agencies from entering into contracts valued at \$1 million or greater without developing specific guidelines for the administration and implementation of the contract. For contracts valued below \$1 million, the agency would use department or similar guidelines including 1) documentation to support the contract solicitation and selection process, 2) policies to ensure contractors do not provide services until an executed contract is in place, 3) cost-effective methods to track contracts and 4) filing of contracts and related documentation. If review is required by rule of the General Services Department or Department of Finance and Administration (DFA), the agency would be required to submit the contract for review no less than 30 days prior to the effective date.

The bill would require, subject to specified exemptions, that state agencies use performance contracting for contracts for which the maximum amount payable is \$100,000 or more. The performance contracts would include 1) performance measures developed by the agency for that contract that will be used by the agency to evaluate the services, 2) an accountability section that requires the contractor to report regularly on how performance levels are being met and allows the agency to withhold payment until successful completion of all or part of a contract, and 3) monitoring requirements that outline the agency's evaluation of the contractor's performance..

DFA would be responsible for 1) assisting agencies in developing and managing the contracts (including training courses), 2) developing policies for performance accountability in contract management, 3) preparing guidelines for agencies to conduct meaningful contract evaluations and provide for different types of evaluations depending on the types and amounts of the contracts, 4) preparing guidelines for agencies on performance contract specifications and other specified aspects of performance contract implementation and 5) selectively monitoring contract procedures and projects in agencies.

The Act would apply to any contract entered into by a department, institution, board, bureau commission, district or committee of the state, except for:

1. litigation expenses in connection with proceedings before administrative agencies, state or federal courts (including experts, mediators, court reporters, process servers, and witness fees but not including attorney contracts).
2. hospital- and health-care-related service exempt from the procurement code pursuant to Section 13-1-98.1 NMSA 1978.
3. emergency procurements under statute
4. contracts exempted by rule of the DFA or order of the DFA secretary

DFA would develop a schedule so that all agencies implement the Act by the end of FY08.

It would apply to the legislative and judiciary branches but those agencies could develop their own policies and guidelines, may provide their own exemptions, and would not be required to report or make submissions to DFA. No provision of the Act would be applied to any situation in which the application of the provision would directly or indirectly impair a legally protected right. The bill would be effective July 1, 2006 to allow time for implementation.

Significant Issues

According to the U.S. General Services Administration, performance contracting has been around for over 20 years. In October 1998, the Office of Management and Budget published a guide to best practices in performance-based service contracting. In 2001, the President set a goal of converting 50 percent of all federal service contracts to performance based contracts. Implementation of this program is well underway in the federal government.

LFC staff studies in 1999 and 2000 have shown that New Mexico state government's contract management and accountability system needs improvement. The 1999 study noted that the state's expenditures for contract services have grown by \$1.6 billion from FY95 to FY00. The 2000 study reviewed six state agencies' contract policies and procedures and found they are generally inadequate for financial accountability or quality control. A joint study by Governing magazine and Rutgers University study released in January 2001 noted that contracting in New Mexico is "very decentralized, leaving problems with the potential to fester unnoticed."

In *Moving New Mexico Forward: Further Along*, issued in August 2004, Governor Bill Richardson endorsed the use of performance contracting in the New Mexico Department of Environment. That report provides a good example of the potential benefits of performance contracting in its findings:

"The New Mexico Department of Environment makes payments...to contractors and storage tank owners based on criteria related only indirectly to the effectiveness of the cleanup conducted at the contaminated site. The department awards contracts based on a combination of low bid and the engineering design for the proposed work. Once the contracts are awarded, payments to the contractors are not related to the actual results achieved. The current NMED approach rewards firms that submit bids proposing systems that may be relatively inexpensive up-front but take a long time to complete. The current approach also unintentionally encourages contract change orders that often add incremental costs not approved at the outset. Change orders can cause the ultimate costs of the cleanup to be much higher than the original bid. Perhaps most important, the current approach does not verify whether the cleanup has been successful before payments are made... Fourteen states employ some form of PFP (pay-for-performance) contracting for their state clean up funds... NMED should adopt PFP contracting using contracts that require achievement of specific environmental results before the contractor receives payment."

Some state agencies are already implementing performance-based contracting. For example, the 2004 General Appropriation Act included language requiring the Department of Health (DOH) to include performance measures in its outcome-based contracts to increase oversight and accountability. DOH indicates that their Contracts and Grants Bureau is implementing review of all contracts to ensure that the deliverables and performance measures support the strategic activities necessary to achieve the overall department strategic goals. Also, DOH is requiring a summary of contractor performance on a quarterly basis to be shared across the department.

Some agencies were concerned that the requirements in SB283 would be burdensome or delay timely award of contracts. The Department of Education indicated that the bill's additional requirements for performance measures and measurement monitoring could impact the timely delivery of service and possible loss of federal funds (i.e., when short time frames are allowed for reallocated dollars) with regard to 13 agency contracts (down from 100 contracts in the original

version of the bill).

The HGUAC substitute generally streamlined the contracting process specified in the original bill and addressed a few specific concerns that arose with regard to the original bill, such as providing sufficient time for transition/implementation of the new contracting requirements.

PERFORMANCE IMPLICATIONS

Enactment of this bill would provide greater accountability for the use of taxpayer dollars to fund professional services contracts entered into by state agencies. Expanding DFA's role in the management of professional services contracts would potentially improve accountability in the ongoing management of contracts and by supporting agencies' use of performance contracting. Nationally, agencies that have adopted performance contracting report significant savings and improved performance.

FISCAL IMPLICATIONS

The growing popularity of performance-based contracting reflects experiences in federal government and in many state governments that this is a cost-saving approach to achieving outcomes desired by agencies. For example, the Governor's report, *Moving New Mexico Forward: Further Along*, offered the following example with regard to environmental clean-up contracts:

“Nebraska, Oklahoma, Florida, South Carolina, and Vermont are considered the leaders and have achieved millions of dollars of cost savings using PFP [pay-for-performance] contracts for site assessment and environmental remediation.”

Agencies generally indicated they could absorb the costs of implementing performance budgeting with existing staff. The Public Education Department had anticipated a need for additional staff under the original bill, but indicated that the HGUAC substitute simplified the process sufficiently that additional staff would not be required. The Department of Corrections (DOC) indicated the agency could likely absorb the costs and administrative burden of negotiating, drafting and carrying out performance contracts. The Human Services Department indicated uncertainty as to additional staff may be required to comply with the additional duties in the bill. DOH indicated it may incur additional costs to evaluate decisions to contract but that this is an important aspect of effective contracting.

ADMINISTRATIVE IMPLICATIONS

See fiscal implications for general discussion of staffing and resource implications of the bill.

Additionally, DOH was uncertain on how to apply the objective evaluation requirement in the substitute bill in those instances where a federal grant award is based on a work plan that says contracts will be awarded for certain services or programs, or whether these requirements apply at all to contracts awarded using federal funds.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Companion to SB330.

DH/sb