



**SUNSET REVIEW**

**PRIVATE ENTERPRISE REVIEW BOARD**

**Report to the Arizona Legislature  
By the Auditor General  
March 1996  
Report 96-3**

March 6, 1996

Members of the Arizona Legislature

The Honorable Fife Symington, Governor

Mr. Hank Bried, Chairman  
Private Enterprise Review Board

Transmitted herewith is a report of the Auditor General, A Performance Audit of the Private Enterprise Review Board. This report is in response to a May 17, 1995, resolution of the Joint Legislative Audit Committee. The performance audit was conducted as part of the sunset review set forth in A.R.S. §§41-2951 through 41-2957.

The report addresses the potential role PERB can play in providing a forum between business and state policy makers and the changes that are needed in its operations that would allow it to better fulfill this role. As designed by statute, PERB's role is to review complaints from private businesses regarding unfair competition by state agencies and then forward its recommendations to the Legislature and the Governor. Additionally, PERB has the authority to review exemptions to current competition laws and make recommendations regarding whether the exemption continues to be justified. Although a somewhat dormant body in years past, the current Board, which has been in place since 1993, has a renewed enthusiasm for its role in eliminating unnecessary competition and increasing privatization. However, we found that PERB has not fulfilled its potentially important role because it has not developed recommendations and reported to the Legislature and the Governor in each of the cases it has reviewed. The Board's effectiveness has also been limited by a lack of adequate staff support. The Department of Commerce, the agency statutorily mandated to provide necessary support, needs to ensure sufficient staff support to PERB for it to be effective.

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Given PERB's past history of inactivity, as well as its current need for operational improvements, the Legislature may want to consider extending PERB's function for a period of only three to five years. This should allow sufficient time to demonstrate its viability and impact on state government services.

My staff and I will be pleased to discuss or clarify items in the report.

This report will be released to the public on March 7, 1996.

Sincerely,

A handwritten signature in cursive script that reads "Douglas R. Norton". The signature is written in black ink and is positioned above the printed name.

Douglas R. Norton  
Auditor General

Enclosure

# SUMMARY

The Office of the Auditor General has conducted a performance audit and sunset review of the Private Enterprise Review Board, pursuant to a May 17, 1995, resolution of the Joint Legislative Audit Committee. The audit was conducted under the authority vested in the Auditor General by Arizona Revised Statutes (A.R.S.) §§41-2951 through 41-2957.

The Private Enterprise Review Board (PERB) is mandated to review complaints about state agencies competing with private enterprise in violation of statutes restricting competition. The Board is required to report the results of its reviews to the Legislature, the Governor, and the complainant. The Board is also empowered to review the exemptions from these laws granted to certain state agencies and make recommendations to the Legislature and the Governor regarding whether the exemption should be changed. Further, the Board may also evaluate opportunities for the State to contract out certain functions to private enterprise.

The Board consists of nine volunteer members and four ex officio members from the Legislature. The Board has no appropriation or staffing of its own. By statute, the Department of Commerce must provide staff support to the Board.

The role of PERB is considered an important function in state government. Specifically, representatives from private business and state government agreed that a forum is needed for businesses that have complaints about competition by state agencies and proposals for contracting out state functions. Moreover, recent appointments to the Board have revitalized enthusiasm for the role it can serve. However, we found that PERB lacked adequate procedures and staffing to allow it to meet this potential.

## **Operational Improvements Needed to Enhance PERB's Effectiveness (See pages 5 through 12)**

Though PERB could play an important role as a forum for business, it has not performed to its full potential. While it was established in 1983 to review state government functions that compete with private enterprise, PERB was relatively inactive and generally unknown to the business community until 1993, when new appointments to the Board brought renewed enthusiasm for its role. However, since PERB has become more active it has heard only five cases and even in these cases, has not completely fulfilled its statutory responsibility of reporting its recommendations to the Legislature and the Governor.



Many of these problems are due in large part to lack of procedures guiding the Board's activities. Additionally, the Board is hindered by a lack of staffing, without which it has difficulty maintaining records and improving public awareness of its functions. In order to become more effective, the Board needs to improve its procedures to ensure that it handles its duties efficiently and to ensure that its mandates are met. Further, PERB will need sufficient staff resources to adequately maintain Board records and improve public awareness of it. To this end, the Department of Commerce should provide sufficient staff support for PERB.

## **Sunset Factors** **(See pages 17 through 19)**

Our report also contains responses to the 12 Sunset Factor questions in accordance with A.R.S. §41-2954. In response to the question regarding the continued need for PERB, we noted that given its past history of inactivity and need for operational improvements, the Legislature may want to consider extending PERB's function for a period of only three to five years. This should allow sufficient time to demonstrate its viability and impact on state government services.

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# INTRODUCTION AND BACKGROUND

The Office of the Auditor General has conducted a performance audit and sunset review of the Private Enterprise Review Board (PERB), pursuant to a May 17, 1995, resolution of the Joint Legislative Audit Committee. This audit was conducted as part of the sunset review set forth in Arizona Revised Statutes (A.R.S.) §§41-2951 through 41-2957.

## History

In 1981, the Legislature prohibited state agencies from providing goods and services in competition with private enterprise unless clearly authorized to do so by law. At the same time, the Legislature created a temporary study commission charged with reviewing state government functions that compete with private enterprise. In 1983, the Private Enterprise Review Board was created as a permanent board, but underwent several changes before its current statutory mission was adopted in 1987. Among the changes PERB experienced was the transfer of staff support from the Department of Administration to the Legislative Council, and finally, to the Department of Commerce. Furthermore, two members of the Legislature served as voting members of the Board previously, and now four members serve in an ex officio capacity. Also, at various times prior to 1993, the Board was inactive and rarely met. This inactivity was reversed with renewed interest in the Board from the private sector. In fact, the current Board has essentially been meeting monthly, although it is only required to meet four times per year. In addition to attending the meetings, Board members volunteer time to review materials, attend legislative hearings, and participate in other Board activities.

## **PERB Mandated to Review Competition Complaints and Opportunities to Contract Out Government Functions**

PERB is mandated to hear complaints about state agencies competing with the private sector in violation of the State's competition laws and to evaluate if a violation has occurred. The Board is required to report the results of its hearings to the Legislature, the Governor, and the complainant. PERB may also evaluate opportunities for the State to contract out certain functions to private enterprise. In addition, the Board may evaluate competition exemptions allowed to certain agencies. PERB is required to report its findings and recommendations to the Legislature and the Governor after each meeting.

To fulfill its mandates, the Board holds monthly meetings at which complainants, or private sector representatives with contract proposals and the agencies involved, are given the opportunity to present their cases. Furthermore, individual board members are assigned in



some cases to investigate the merits of complaints and proposals, which typically includes reading submitted material and interviewing concerned parties.

## Organization and Staffing

PERB is comprised of nine members who serve two-year terms.<sup>1</sup> As required by statute, six are private sector representatives, one is a state agency representative, one is a representative of the Board of Regents, and one is a representative of the community colleges. In addition, there are four non-voting, ex officio members from the Legislature, including two from each house. By statute, the Department of Commerce must provide staff support at the Board's request. Specific support comes from the Department's Small Business Advocate, who keeps the Board's records, publicizes the Board to the business community, and forwards issues for its review. One legislator's assistant also keeps the minutes at board meetings, and a legislative research analyst assists the Board in drafting legislation.

## Audit Scope and Methodology

This audit focused primarily on PERB's ability to hear complaints regarding agencies' competition with private enterprise, and secondly, on its ability to evaluate opportunities to contract out state functions. To evaluate these efforts, PERB meetings were observed and board minutes dating back to August 1993 were reviewed. In addition, we interviewed seven board members, and all four legislators serving as ex officio members of the Board. We also interviewed all the complainants and agency representatives involved in cases brought before the Board over the past two years.

Furthermore, to determine PERB's effectiveness in evaluating opportunities to contract out public services, we contacted other states and public organizations noted for their accomplishments in contracting out public functions. Finally, a focus group of professionals representing state agencies, the Governor's Office, the Joint Legislative Budget Committee staff, the City of Phoenix, and the private sector was held to obtain their perspectives on how the State should evaluate opportunities to contract for goods or services.

During the audit we sought to define what PERB's proper role regarding competition and privatization should be, and to measure the Board's impact on the State in these areas. In addition, we examined other options for achieving PERB's mission by looking into alternatives for staffing and oversight.

We included other pertinent information describing the scope and complexity of evaluating opportunities to contract out public functions on a statewide level.

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<sup>1</sup> Of the nine members, three are appointed by the Governor, two each are appointed by the Speaker of the House and the President of the Senate, and one each by the State Board of Directors for Community Colleges and the Arizona Board of Regents.

This audit was conducted in accordance with government auditing standards.

The Auditor General and staff express appreciation to the PERB members, and the staff who have served them, for their cooperation and assistance throughout the audit.

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## FINDING I

### OPERATIONAL IMPROVEMENTS NEEDED TO ENHANCE PERB'S EFFECTIVENESS

The Private Enterprise Review Board (PERB) needs to make several operational improvements to enhance its role as an intermediary between private enterprise and state policy makers. PERB has not adequately met its responsibility as an information resource for policy makers due to its limited activity and failure to develop recommendations and issue mandated reports on all cases it has reviewed. Overall, the Board's ability to function has been hindered by a lack of adequate procedures and staffing. To enhance its performance, the Board must develop procedures guiding its complaint review and contracting proposal review processes. Furthermore, the Department of Commerce should ensure adequate staff support is provided to PERB.

#### **Need for a Forum**

PERB deals primarily with complaints from private enterprise that state agencies are competing with their businesses. The Board's role is to review complaints of competition by state agencies and forward its recommendations to the Legislature and the Governor. During the course of our audit, representatives from both the private sector as well as state agencies involved in the complaint process indicated a forum is needed for private business to bring competition complaints, since there is no other mechanism within state government to perform this function. Through its review process, PERB can provide agencies with a method for handling these complaints through a third party and bring these issues to the attention of policy makers through its reports and the Board's ex officio legislative members. Further, Board members believe that by giving businesses a last resort before filing a lawsuit, it can save the State litigation costs. In addition, PERB's secondary role of evaluating and reviewing opportunities to contract with private enterprise is also deemed important because it can serve as a source of public input into privatizing state functions.

Although PERB had in the past been somewhat dormant, recent appointments of new private sector representatives have revitalized enthusiasm for its role. As an entity in state government intended to consider competition complaints and evaluate and review opportunities to contract with private enterprise, PERB has the ability to make recommendations to state policy makers that work toward the ultimate goal of enhancing government services to the public.



## **PERB's Impact Limited by Little Activity and Failure to Report to Policy Makers**

Although it has a potentially important role, the Board has not performed as well as it might have because of its limited activity and failure to develop recommendations for policy makers. Specifically, the Board's impact is limited due to the relatively few cases it has heard and a poor awareness of PERB on the part of Arizona businesses. Moreover, the Board does not consistently develop recommendations and report them to the Legislature and the Governor as required by statute, preventing it from being a viable source of information for policy makers.

*Limited activity and poor public awareness*—Limited exposure has hindered PERB's ability to demonstrate its viability within state government. In fact, despite statutes mandating that the Board meet at least four times each year, before 1993 PERB underwent a period of approximately a year where it did not meet at all. While the Board was reconvened in August 1993 under more active leadership, it has received only a handful of cases in the last two years. Specifically, it has only considered these five issues:

- A complaint filed in June 1993 against the Department of Economic Security (DES) argued that DES unfairly competed with a DES contractor in providing several employment-related services. The Board dismissed the complaint, agreeing that DES' statutes allowed the Agency to provide these services.
- The Department of Agriculture's seed quality testing service was the subject of a complaint in June 1994. A private company felt that the Department's fees were too low and undercut their business. PERB found the Department had specific statutory authority to operate a seed testing laboratory, and therefore ruled it had no authority to provide relief in this case.
- In October 1994, a private real estate school asserted that the Department of Real Estate (DRE) offered free courses to agents in competition with the school. Though the Agency argued that its statutes allowed this, the complaint was withdrawn when DRE offered to let an independent panel of industry experts examine the issue.
- A company that specializes in revegetating disturbed land filed a complaint in February 1995 because the Department of Transportation (ADOT) had begun doing work that was previously contracted to the private sector. This complaint is still under review by the Board.

- In another complaint filed in February 1995, a traffic signal maintenance company alleged that ADOT was no longer willing to contract traffic signal maintenance. The Board continues to monitor ADOT's development of a contract for this service.

One reason for the small caseload could be that the business community is generally unaware of PERB's existence. For example, representatives of the business community we spoke with suggested that only a small percentage of them are aware of PERB. In fact, of the five cases PERB has received, only one contacted PERB as a result of PERB's efforts to publicize itself. Two were filed by or with the encouragement of Board members, one reached PERB through a long process of referrals, and one was the renewal of an old complaint. In addition, an agency official involved with PERB commented on the Board's low visibility, adding that greater public awareness might generate more complaints to PERB. Moreover, Board members themselves expressed dissatisfaction with the public's awareness of PERB. While several noted that people with complaints or contracting proposals will eventually find the Board, others said that the lack of visibility may prevent potential cases from ever reaching it.

*Failure to report pertinent information to policy makers*—While Board members view their role as an intermediary between business and the State, PERB has not officially served as a forum to relay concerns to state decision makers. As mentioned earlier, statutes require the Board to report the results of its reviews, including recommendations, to the Legislature and the Governor. While the Board Chairman contends that PERB has reported to policy makers, it could only produce evidence of one such report, and even then it only reported indirectly. In that particular case, a letter addressed to the agency director raised questions regarding the appropriateness of providing services that appeared to be in competition with the private sector. While a copy of the letter was sent to the Governor as well as the President of the Senate and Speaker of the House of Representatives, it did not recommend that those individuals pursue further action. Instead, it requested that the agency again review the cases and initiate appropriate action.

While PERB argues that a lack of resources prevents it from fulfilling its reporting mandates, by failing to submit specific reports, PERB has missed valuable opportunities to officially inform policy makers about these issues.

Moreover, the Board has further limited its usefulness to policy makers by not taking the opportunity to review the exemptions to the private enterprise statutes. As mentioned earlier, statutes exempt certain agencies and programs from the restrictions against competing with private enterprise.<sup>1</sup> In two of the complaints reviewed, PERB ruled that the agencies involved had such exemptions and therefore, could provide the services in question. However, in at least one case, PERB did have concerns regarding the allowed

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<sup>1</sup> A.R.S §41-2752 prohibits state agencies from engaging in the manufacturing or sale of any goods or services to the public also offered by private enterprise. The statute exempts specific programs and agencies, such as the Office of Tourism, *Arizona Highways* magazine, and any other program specifically authorized by law.



exemptions. In this case, PERB questioned whether the agency should offer the service in competition with the private sector, how its pricing should be determined, and whether it was economically justified for the agency to be providing the service. While the Board could have conducted further review to determine the continued need for the exemption, it failed to do so, unaware it had this authority.

Finally, when reviewing contracting opportunities, the Board is unable to consider and report all the factors that go into a contracting decision. For example, a primary reason for choosing to contract out a function would be to lower an agency's costs. However, Board members complain that agencies are unable to determine precisely their operating costs, hampering its ability to recommend to the Legislature and the Governor whether the proposal could save the State money. In addition, PERB's failure to develop and present reports to policy makers causes many important contracting issues, such as impact on state employees and contract monitoring, to be neglected.

### **Ability to Function Hindered by Lack of Procedures and Staff**

PERB's ability to reach its full potential is hampered by its failure to establish adequate procedures and lack of effective staff support. Specifically, the Board has failed to adopt procedures to guide its review of competition complaints and contracting proposals. Further, PERB's lack of adequate staffing hinders its ability to keep adequate records or promote itself to the business community.

*PERB lacks adequate procedures*— Beyond what is specified in statute, the Board does not have procedures governing its hearing process for both competition complaints and opportunities to contract with private enterprise.<sup>1</sup> As a result, the Board lacks specific guidance in areas such as how it will involve an agency in a complaint review or contracting proposal, investigate complaints, review contract proposals, and evaluate statutory exemptions:

- PERB gives agencies little guidance on how to respond to competition complaints or contracting proposals, leaving them unaware of what information the Board expects from them.
- PERB has no procedures for investigating complaints of agency competition with private enterprise. Without a structured process, complaint investigations conducted by board members resulted in problems in at least one case. In this instance, two board members contacted the complainant before the state agency had developed its

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<sup>1</sup> PERB's statutes specifying time limits within which the Board has to develop findings on complaints also require that the Board solicit an agency response, and define whom the Board reports to.

response, creating the appearance of bias on the part of the board members. As a result, these two members excused themselves from further consideration of the complaint.

- PERB lacks guidelines regarding its proper role in evaluating privatization proposals and has not defined when its involvement should end. The absence of such guidelines has appeared to result in PERB continuing to consider cases beyond its authority. For example, in the two ADOT-related privatization proposals, while the Agency has agreed to accept bids for the services, PERB has not terminated its involvement. It continues to exceed its limited authority to evaluate and review contracting opportunities by monitoring the bidding process of one of the services.
- PERB has no procedure to guide the Board in determining if an agency's statutory exemption for providing a service continues to be justified. Therefore, as mentioned earlier, when PERB has had concerns about an agency competing with private enterprise, it has neglected to fully utilize its statutory authority to examine the appropriateness of the exemption and report its findings to policy makers.

***Untimely resolution of issues***— Without the necessary procedures to expedite its reviews, PERB has failed to resolve issues before it in a timely manner. While statutes allow PERB 60 days to issue a report of its findings after receiving an agency's response to a competition complaint, PERB has never met this deadline. For example, in the complaint against DES, PERB deliberated on the agency response for over six months before it reached its decision. The agency representative involved in the case commented that PERB's lack of procedures allowed extraneous issues to delay complaint resolution.<sup>1</sup>

***PERB hampered by lack of staff***— PERB's ability to meet its potential is further hampered by its lack of sufficient staff support. Since 1987, the Arizona Department of Commerce has been responsible for providing staff for PERB. While statutes require that the Department provide “such staff support as is necessary to carry out the board's duties,” there are no provisions for funding. Therefore, PERB uses the Department of Commerce's Small Business Advocate as a point of contact with the public and to coordinate the review of complaints and contracting proposals. However, the Advocate is unable to dedicate more than a fraction of his time to the Board. As a result, for important functions such as coordinating and recording meetings, the Board must supplement the Advocate with a legislative secretary and a legislative research analyst. However, neither of these staff give more than a fraction of their time to supporting the Board.

This split in staff support has resulted in inadequate recordkeeping and ineffective public promotion of PERB. No one person or agency is responsible for enforcing the Board's reporting mandates or maintaining PERB's public records. In fact, there are no records

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<sup>1</sup> The complainant added two additional issues to the complaint six months after the initial filing date. One month after this, the complainant proposed a pilot project to prove he could operate more efficiently than DES.



available from any meetings or activity prior to 1993. In addition, although the Department of Commerce's Advocate mentions PERB during speeches or in articles he writes, there has been no one to work steadily at improving the business community's awareness of PERB. While the Department of Commerce's Advocate feels that a pamphlet or brochure describing PERB could be developed and distributed to businesses, he stated that he does not have the resources to prepare it.

## **Better Procedures and Stronger Staff Support Needed for Improvement**

In order for PERB to effectively carry out its duties, improvements are needed in the Board's processes and staffing. First, PERB must adopt policies and procedures that will guide the Board in its review process and ensure that it can fulfill its role. In addition, the Department of Commerce should provide adequate staff support to assist the Board in improving its processes, maintaining board records, and encouraging greater public awareness of PERB.

*PERB needs to improve its processes*— First and foremost, PERB must develop separate procedures to guide how it handles complaints, evaluates contracting opportunities, and reviews agencies' exemptions. These changes are necessary to ensure each case is studied in an efficient and appropriate manner. Therefore, the Board should adopt basic procedures to:

- **Determine the type of issue it is considering** upon receipt of the complaint or proposal. For example, PERB should determine whether the issue identified in a complaint is actually a complaint that a state agency is competing with a business or if it is a proposal for contracting a function out to the private sector. These two roles are substantially different, and PERB should recognize this in defining its guidelines. For example, PERB's procedures for competition complaints must take into account the statutes that define when the agency must respond and when PERB must make its finding. In contrast, if the issue is a contracting proposal, PERB should develop a process that follows its statutory requirements to review the issue and develop a report to policy makers recommending the appropriate action to take if further consideration is warranted.
- **Establish guidelines that clarify the Board's role and purpose** in reviewing complaints and proposals. Specifically, when developing these processes, the Board should also define when its role in a case ends. For example, as previously mentioned, the Board has exceeded its statutory authority with regard to two proposals to privatize services within ADOT. Rather than issuing a report evaluating the projects, PERB continues to monitor ADOT's efforts to contract out those services. As a result, the Board's involvement appears to have no definite end. By establishing

and following procedures guiding the Board, PERB can define how it studies an issue and when it must conclude the study.

- **Educate agencies about their roles in the process.** As mentioned previously, PERB has not provided adequate guidance to agencies responding to competition complaints. Agencies indicated they did not know what to expect when appearing before the Board. By better educating participants about PERB's process and their roles in it, PERB can focus the hearing process and resolve issues before it in a more timely fashion.
- **Inform policy makers** by consistently reporting to the Legislature and the Governor its recommendations regarding competition complaints, agency exemptions, and contracting opportunities. Currently, statutes require PERB to provide complete reports of *each meeting*, including its recommendations, to the Legislature and the Governor. As the Board meets virtually on a monthly basis, this essentially means it must report to the Legislature and the Governor each month. Although this requirement may be excessive, at a minimum the Board should have provided a report at the conclusion of each complaint review. Therefore, to allow the Board to provide more meaningful reports, the Legislature should consider amending A.R.S. §41-2754.D.7 to allow the Board to report its recommendations only at the completion of its reviews.
- **Inform complainants** of PERB's findings in issues of competition by state agencies. In addition to reporting the Board's recommendations to policy makers, PERB's statutes require that it issue a written report of its findings to the complainant.

*PERB needs adequate staffing*—The Department of Commerce should provide more adequate staff support to assist the Board in improving its procedures, maintaining records, and increasing public awareness. As mentioned previously, statutes currently require the Department of Commerce to provide necessary support for PERB; yet the Department believes PERB's “regulatory” function of reviewing complaints from private businesses is incompatible with the Department's “non-regulatory” role as an advocate for business. As a result, it has neither provided adequate assistance nor sought resources from the Legislature. Meanwhile, the Department plans to support proposed legislation to transfer PERB's staff support to the Governor's Office for Excellence in Government (OEG). In fact, the Board itself supports this move, as members believe that placing it within the Governor's Office would increase the Board's ability to influence agencies in both competition and privatization issues.

However, unless and until this function is placed elsewhere, the Department of Commerce should provide the necessary resources to support PERB. Not only do we question the Department's assertion that its role and PERB's role are incompatible, we note that the Department is statutorily mandated to staff PERB. Therefore, the Department of Commerce should dedicate sufficient staffing to support PERB. If the Department determines it needs additional resources for this function, it should justify the need in a budget request to the Legislature.



Once PERB has sufficient staff support it could begin not only to develop procedures, but to enhance public awareness of its function. For example, it could formalize and increase its interaction with business associations such as the Arizona Chamber of Commerce, the National Federation of Independent Businesses, and the Fiscal Accountability and Reform Efforts (FARE) Committee to elevate its visibility in the private sector. These associations might be invited to provide periodic reports to PERB, while in turn, PERB might make presentations to the associations. In fact, FARE has shown strong support for PERB by seeking to reinvigorate PERB activity, recommending members for board appointment, and promoting PERB-sponsored legislation.

## RECOMMENDATIONS

1. The Legislature should consider amending A.R.S. §41-2754.D.7 to change the Board's reporting requirement to the Legislature and Governor. Rather than reporting results of *each meeting*, the Board should be required to report its recommendations only at the conclusion of a competition complaint, privatization proposal, or agency exemption evaluation.
2. To provide for a more effective complaint-handling approach, PERB should adopt procedures to guide its review process and ensure compliance with statutory mandates. Basic procedures that should be adopted include:
  - Determining the type of issue it is considering upon receipt of a competition complaint or privatization proposal,
  - Establishing guidelines that clarify the Board's role and purpose in reviewing complaints and proposals, ensuring that the Board's involvement in a case does not exceed its statutory authority,
  - Better educating agencies about their roles in the process,
  - Directly reporting recommendations from all reviews to the Legislature and the Governor, and
  - Informing complainants of its findings.
3. The Board should use its ability to review the statutes that exempt agencies from the laws on competition. When applicable, PERB should review exemptions to examine their appropriateness and report its recommendations to the Legislature and the Governor.
4. Unless and until the responsibility for staffing PERB is transferred to another agency, the Department of Commerce should provide sufficient staff support to assist PERB in establishing its procedures, maintaining records, and increasing public awareness.

## OTHER PERTINENT INFORMATION

Due to the Private Enterprise Review Board's (PERB) statutes authorizing it to evaluate contracting opportunities for state functions, significant research on this topic was conducted. Overall, we found that Arizona is in the very early stages of attempting to address privatization on a larger scale, and that numerous factors must be considered before a meaningful statewide privatization program can be implemented.

*Arizona agencies not prepared for a statewide privatization program*—Arizona currently lacks a consistent, statewide approach to privatization, and is not currently prepared to implement one. Privatization opportunities have typically been implemented based on agencies' own initiatives. Therefore, the State as a whole has not considered all the policy implications and risks of a statewide program. For example, our focus group of business, legislative branch, and executive branch representatives concluded that a statewide program would require agencies to analyze their own in-house services and compare them with potential private service providers. However, according to the group, state agencies have great difficulty identifying the total costs for providing services. As a result, several participants agreed that agencies need more training to capture these costs with the State's current accounting system. PERB has recognized this as an issue and has been involved in the development of a costing model to help agencies better identify their costs.

Further, there are no state policies in place to consider various factors in evaluating privatization opportunities. As a forerunner among state agencies using privatization, the Arizona Department of Transportation (ADOT) has developed many of its own policies while discovering the need for still others. For example, the Agency has developed a process to review contract proposals, calculate in-house costs, evaluate various service impacts, and compare costs to vendors' bids. However, based on ADOT's own review of its pilot effort, the Agency can improve on calculating the cost to contract out, selecting vendors, and monitoring vendor performance.

Moreover, members of our focus group agreed that a statewide privatization program would need well-established, communicated, and measured goals; motivation for agencies to participate; and an audit process to ensure fairness and accuracy. As a result, if the executive branch were to try to carry out a statewide privatization program, it would need to establish guidelines and procedures for its agencies. Toward that goal, the Governor's Office is currently drafting an extensive handbook for agencies to use when implementing competitive government initiatives that would cover some of these areas.

However, given the policy implications and risks of a privatization program, the group felt legislative action might be appropriate before any statewide programs were adopted. In fact, the group pointed out that the Legislature has yet to make a policy decision on whether it even wants a statewide competitive government program. If it does want such a program, the focus group felt the Legislature could initiate its development by statutorily outlining



a competitive government program and defining its mission, as was recently done in the State of Texas.

*Other organizations have addressed contracting issues*—Unlike the State of Arizona, the states of Texas and Georgia, and the City of Phoenix, have addressed the contracting out of government services in an organizationwide manner. Examples of issues addressed by these organizations include:

- **Comparing Costs**—Organizations need to fairly and consistently compare the costs of providing a service in-house versus by contract. For example, Texas attempts to do this by offering its agencies an approved cost methodology to use during the agencies' cost analysis and comparison process. For example, agencies must:
  - use one of several approved methods for calculating direct and indirect in-house costs;
  - calculate contracting costs by including the private vendor's as well as the state's cost to convert to and administer the service;
  - compare the in-house costs (minus any costs that will not be avoided by contracting out) to the costs to contract out.

Texas' methodology is similar to one proposed by a leading research organization that studies privatization. Also, the City of Phoenix uses a similar approach, and follows up with audits to ensure that affected departments perform the analysis objectively.

- **Assuring Quality Service**—In contracting out its services, government organizations need to assure that quality is maintained, if not improved. For example, the City of Phoenix seeks this assurance by holding its departments responsible for monitoring contracted services and expecting them to establish inspections, and by using a system for receiving feedback on contractors' quality of services. Additionally, since the operating department retains responsibility for providing the service, it needs to be prepared to take over the function if the contract fails. Furthermore, within 12 months of being implemented, the City Auditor reviews and reports on the cost and quality of the contracted service. Georgia also addresses quality assurance through its statewide policies. For example, contracts are to include performance incentives for vendors, as well as requiring bonds to cover the State's liability for poor performance by vendors. Furthermore, contracts must specify performance standards and criteria as well as access to all data necessary for monitoring. Finally, agencies must devote adequate resources to properly monitor and evaluate private vendor services.

- **Mitigating Employee Impact of Downsizing**— Governments have also used a variety of methods to reduce privatization's impact on their existing employees. For example, the City of Phoenix mitigates job displacement by:
  - freezing vacancies in other departments with similar positions prior to possible displacement of employees,
  - requiring that contractors hire displaced city employees, and
  - requiring minimum health insurance benefits for contractors' employees.

Furthermore, Georgia has recently established a statewide policy to:

- encourage interagency placement of displaced employees,
  - reduce the workforce through attrition, retirement, transfer, and outplacement rather than layoffs,
  - help displaced employees with obtaining affordable insurance, and
  - provide placement services and counseling to displaced employees.
- **Overcoming Internal Resistance**— Finally, public organizations are overcoming potential internal resistance by ensuring elected officials' support and focusing on meeting customers' needs. For example, Texas created a joint legislative and executive council of elected officials with extensive authority to identify privatization opportunities, and implement them through agencies. The City of Phoenix also has elected officials' support for competitive government. In addition, even in times of budget reduction, it continues to hold its departments to existing customer service expectations. These pressures have led agencies to seek ways to privatize.

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# SUNSET FACTORS

In accordance with A.R.S. §41-2954, the Legislature should consider the following 12 factors in determining whether to continue or terminate the Private Enterprise Review Board.

**1. The objective and purpose in establishing the Private Enterprise Review Board.**

The Legislature created the Private Enterprise Review Board (PERB) in 1983. According to board members, the Legislature intended the Board to provide a means for citizens to complain about unfair governmental competition with business, or issue proposals to privatize certain agencies' activities. Statutes mandate PERB to hear complaints about state agencies competing with the private sector in violation of competition statutes and to evaluate whether violations have occurred. PERB may also evaluate legal exemptions that allow certain agencies to compete with the private sector to determine if the exemptions are justified. In addition, PERB may also evaluate opportunities for the State to contract out certain functions to private enterprise. In all its authorized activities, PERB is required to report its findings and recommendations to the Legislature and the Governor.

**2. The effectiveness with which the board has met its objectives and purposes and the efficiency with which the agency has operated.**

Members of PERB feel the Board has been moderately successful in meeting its objectives. However, our audit indicates it could improve its processes for handling all of its major functions. Specifically, the Board needs to develop a process to review and resolve competition complaints effectively. It also needs to more fully utilize its authority to review agencies' exemptions from competition laws. Finally, it needs to develop a system to quickly and methodically study opportunities to contract out state functions and services (see Finding I, pages 5 through 12).

**3. The extent to which the Board has operated within the public interest.**

PERB operates in the public interest by providing private enterprise a forum within state government to hear competition complaints and proposals for contracting out government functions. This also benefits agencies in that PERB facilitates review and resolution of private enterprise complaints or proposals. Additionally, Board members indicate that they have saved the State from costly lawsuits by offering private businesses a forum for having their complaints addressed, short of taking legal action.



- 4. The extent to which rules and regulations promulgated by the Board are consistent with the legislative mandate.**

PERB has no statutory authority to promulgate rules.

- 5. The extent to which the Board has encouraged input from the public before promulgating its rules and regulations and the extent to which it has informed the public as to its actions and their expected impact on the public.**

Though its meetings have been open to the public, PERB has failed to comply with Open Meeting Law requirements regarding proper notification of Board meetings. Specifically, PERB has not provided a statement to the Secretary of State on where the meeting notices would be posted, as required by A.R.S. §38-431.02.

- 6. The extent to which the Board has been able to investigate and resolve complaints that are within its jurisdiction.**

PERB has statutory authority to investigate complaints regarding competition by state government, though it may only make recommendations to the Legislature and the Governor about their resolution. While PERB has been able to investigate all complaints received in the last two years, it could improve its complaint-handling process by developing procedures that would ensure consistency and thoroughness in its reviews and recommendations (see Finding I, pages 5 through 12).

- 7. The extent to which the Attorney General or any other applicable agency of state government has the authority to prosecute actions under enabling legislation.**

Though PERB has the authority to find that agencies are violating competition laws, it has no authority to impose penalties. In fact, the only defined penalty for agencies violating competition laws is that citizens can sue and receive civil damages.

- 8. The extent to which the Board has addressed deficiencies in the enabling statutes which prevent it from fulfilling its statutory mandate.**

Based on our review, we find no deficiencies that prevent the Board from fulfilling its mandate. However, because PERB recognizes it does not have the authority or resources to effectively evaluate privatization proposals presented by private enterprise, it has proposed legislation to create an executive branch council to perform this function.

**9. The extent to which changes are necessary in the laws of the Board to adequately comply with the factors listed in the Sunset Law.**

Our review did not identify any deficiencies in its enabling statutes that prevent the Board from fulfilling its statutory mandate. However, the Legislature may want to consider amending the Board's reporting requirements as outlined in A.R.S. §41-2754 (see Finding I, pages 5 through 12).

**10. The extent to which the termination of the Board would significantly harm the public health, safety or welfare.**

Termination of PERB would not significantly harm the public's safety, health, or welfare. As mentioned previously, PERB was inactive between 1990 and 1992 and has handled few cases since 1993. However, both private enterprise and state agency representatives believe a forum is needed in state government to which businesses can bring competition complaints. A well-functioning PERB could provide Arizona's private enterprise a meaningful venue through which to seek resolution to their grievances of unlawful or unfair competition from government without resorting to a lawsuit. PERB can also potentially be more of a means of encouraging and evaluating proposals for contracting out state functions in the public interest. Furthermore, as PERB's function is not duplicated elsewhere in state government, combining the Board's responsibilities with another agency does not appear to be a viable option.

However, given PERB's past history of inactivity, and the changes PERB needs to make to increase its effectiveness, the Legislature may want to consider extending PERB's function for a period of only three to five years. This should allow the Board sufficient time to demonstrate its viability and impact on state government services.

**11. The extent to which the level of regulation exercised by the Board is appropriate and whether less or more stringent levels of regulation would be appropriate.**

This factor does not apply as PERB has no regulatory authority.

**12. The extent to which the Board has used private contractors in the performance of its duties and how effective use of private contractors could be accomplished.**

PERB has no appropriations to use private contractors in the performance of its duties.



**Agency Response**





# ARIZONA

Department of Commerce

Fife Symington  
Governor of Arizona

Sara Goertzen Dial  
Director

February 29, 1996

Mr. Douglas R. Norton  
Auditor General  
State of Arizona  
Office of the Auditor General  
2910 N. 44th Street, Suite 410  
Phoenix, Az 85018

Dear Mr. Norton:

Thank you for providing the opportunity for the Department and the Private Enterprise Review Board (PERB) to respond to the performance audit conducted by your office.

The Private Enterprise Review Board members, herein after referred to as the Board, and the Department of Commerce generally concur with the audit findings that are summarized on page 5 of the Performance Audit. The report's findings are to a great extent a result of the following:

1. The enabling legislation was somewhat vague on the specific policies and procedures that PERB should utilize in enhancing competitiveness. However, the Auditor General's report has developed some excellent ideas for consideration.
2. This activity was never provided staffing or funding to carry out its mandate. Due to budgetary constraints, the Department has had to commit all available resources provided by the state to carry out its primary mission of economic development.
3. We still maintain that Commerce is a marketing agency and not a regulatory agency. We feel strongly that there is a distinct difference between Commerce's mission and that of PERB, and that the two are incompatible.

In fact, for the above reasons, Commerce has asked the legislature many times over the past several years to move PERB to a more compatible agency and to provide it with adequate resources to perform its mission. Currently, Representative Bob Burns, the Board and the Department of Commerce are the driving forces behind Senate Bill 1334, which addresses most of the findings of the Performance Audit. This bill, if passed, authorizes the Office of Excellence in Government (OEG) to "provide staff support as is funded by legislative appropriation to the office (OEG) to carry out the board's duties."

Passage of this legislation will authorize OEG to provide the necessary resources and staff support to enable the board to develop and implement appropriate policies and procedures. With OEG staff support and resources the Board would be better able to promote awareness among state agencies and private enterprise, thereby increasing the

number of cases being referred to the Board for resolution. Additionally, with appropriate policies and procedures in place, adequate staffing and resources would allow the Board to effectively make recommendations and issue mandated reports within the prescribed time frame.

Commerce and the Board support this move, recognizing that placement within OEG will increase the Board's visibility. The move will also increase the Board's ability to garner cooperation, commitment, and acceptance by state agencies in both competition and privatization issues.

The OEG also supports this move and has agreed to accept responsibility for funding, staffing and managing the PERB functions on a permanent and proactive basis. This move would strengthen OEG's new "Competitive Government Project." The Competitive Government program applies to potential privatization of programs or services currently being provided using State personnel or resources, and is strategically congruent with the purpose and functions of PERB.

In the unlikely event that Senate Bill 1334 does not pass in the current legislative session, the Department is prepared to submit with the FY 98 - FY 99 Executive Budget Request a budget justification for an additional FTE and funding to provide appropriate staffing and support as is necessary to carry out the board's statutory duties.

The Board and the Department of Commerce will be using the final Auditor General's report and this response to assist in encouraging the passage of Senate Bill 1334. Therefore, we appreciate your actions to expedite the final report.

Sincerely,



Sara Goertzen Dial  
Director

SGD/ds

