LOS ANGELES COUNTY

ECONOMY AND EFFICIENCY COMMISSION

August 17, 1991

Hon. Board of Supervisors
383 Hall of Administration
500 West Temple Street
Los Angeles, CA 90012

Dear Supervisors:

During your budget deliberations Tuesday, July 23, you instructed our Commission and others to reexamine your policy controlling the funding of the Internal Services Department. The specific situation at the time was the layoff or reduction in rank of a number of County employees. You discussed the relevance of that situation to your policies requiring the users of ISD services to fund those services and the CAO's recommendation not to permit ISD to include funding of its cost of living increases for employees in the prices for services performed on behalf of other County departments.

Our Commissioners, Gunther W. Buerk, Alfred P. Balderrama, and Robert H. Philibosian reviewed our past recommendations and discussed the issues with the Chief Administrative Officer, his staff, and the Director of Internal Services. As authorized by our full Commission at its regular meeting on August 7, 1991, this letter contains our recommendations.

OVERALL POLICY DIRECTION

> ***We urge the Board of Supervisors and the CAO to retain the current policy of funding the Internal Services Department through payments of those using its services.***

For economy and efficiency, the Board of Supervisors should require the Internal Services Department (ISD) to manage its functions within a budget that is set by the demands of its clients. Therefore, the needs of client departments should determine the level of services required from ISD. If a Department head believes the in-house services are too expensive, he or she can choose another external producer of the services. The current policy ensures that the cost of support services are only as high as they are required to be by the client departments. ***The alternative is a policy permitting the Internal Services managers or the CAO to determine the level of services.*** It ensures that only the cost of building, furniture, supplies and computers that originate in program needs will be funded. As difficult as the decisions may be at times, the current policy allows County department heads and the Board to trade off support functions with public service functions. The Board has debated and adopted this policy in the past. We believe the Board should retain it. The advantages include:

- The budget for each County department reflects the true costs of the public services it provides, including the costs of space, maintenance, data processing, warehousing, and procurement. This allows the public and the Board to understand the true total costs of County services.

- The managers of the client departments have appropriate economic incentives to keep their demands for support services to a minimum in order to retain enough resources for direct services to the public.

- The managers of Internal Services functions have appropriate economic incentives to operate efficiently, since any client department might choose an alternate producer of support services when they are too expensive.

The County can correct disadvantages of the current overall policy by adjusting the methods of implementing it. In contrast, none of the advantages can be achieved without the policy of charging the consumers of internal services the real cost of the services.

POLICY IMPLEMENTATION REQUIREMENTS

Our detailed recommendations address the implementation issues.

RECOMMENDATION 1

We recommend that the Board of Supervisors instruct the Director of Internal Services to prepare and submit for Board approval a plan for reducing the negative human impact of workforce reductions if they become necessary. The plan should provide for both long term temporary and permanent employees. It should include at least the following (some limited to permanent employees):

- *An outplacement program component,*

- *An early retirement component,*

- ***Suspension of civil service rules where necessary and appropriate.***

No one wants layoffs. The unfortunate reality is, the County lacks the funds to pay for all the demands for its services. Someone will have to decide which of the County's work will go undone, and which jobs will be eliminated. It is the lack of funds or limits on the availability of funds that cause layoffs, not the Board's policies on consolidation or about who should pay for the work. ***Without funding, some reduction of the workforce is inevitable. It may require layoff.***

Outplacement. Today, means are available to minimize the hardship associated with layoffs. Some service companies specialize in planning workforce reductions. Others specialize in providing the services, known generally as "outplacement" services to employees that assist them in finding other jobs. We have on several occasions recommended, and the Board has adopted those past recommendations that the County establish formal outplacement capabilities. We know of no level or department in the County that has implemented them.

Retirement. The County has an early retirement program. Managers should make every effort to make early retirement benefits available to all those who qualify in the event of a workforce reduction. We see no reason why the benefits could not be expanded to include offers to represented employees in the event of cutbacks affecting them.

Formal Termination Benefits. The first cuts in the workforce often affect temporary employees. They have few benefits. They seldom participate in retirement programs, deferred compensation, and the like. We believe that the County should establish a termination benefit package that is designed explicitly for use in emergency cutback situations.

Temporary employees sign on with the clear understanding that they are subject to layoff at any time. However, employees have told us that some County employees have been working for the County in "temporary" positions for long periods. At some point a temporary job is no longer reasonably to be considered temporary. In any event, the point of our recommendation is that the Board and management should act to reduce as much as possible the individual hardships on long term temporary workers created by the need for layoff.

Retraining. Some County employees have highly specialized skills. The County can and should assist employees with training programs to improve their chances of getting alternative work, provided there is an identified need for the positions, and the time required for training is realistic. Training is a temporary, one-time expense. The Board of Supervisors should renew its adopted policy of allocating a proportion of all savings from contracting to a retraining fund.

Civil Service Rules. The Civil Service Rules do nothing to affect the decision of whether to layoff workers and eliminate jobs. However, the civil service provisions for seniority, and their parallels in collective bargaining agreements, cause a cascading effect that determines who will bear the impact of the layoffs. The rules also prevent managers from exercising discretion in where and how to cut overhead costs. Any incumbent in an administrative or supervisory job can displace subordinate workers in case of layoff. That can mean that temporary and the least senior permanent employees are the only ones subjected to layoff, regardless of considerations of performance. We believe a re-examination of the rules is in order.

RECOMMENDATION 2.

We recommend that the Board of Supervisors direct the Chief Administrative Officer and the Director of Internal Services to

- *Permit departments to produce work in house which competes with the Internal Services Department only upon Board approval.*
- *Budget so that the client departments fund the total operational cost of services they purchase from the Internal Services Department, including wage increases, cost of living allowances, and other costs of doing business.*
- *Audit each Department producing its own in house support services at least once every five years to determine the costs and benefits of the arrangement.*

Under the current policy, County departments have the power to correct deficiencies of ISD services. They can choose another producer of the services. Prior to this policy, none had any responsibility for facilities acquisition, space management, facilities operations and maintenance, data processing, purchasing, storage and other business functions. In-house monopolies had the sole responsibility. The central service departments had no competition. Support services became lax, unresponsive, and expensive. It became control-oriented. It lost sight of the service mission.

External competition has remedied this situation. The Internal Services Department has improved. As Supervisor Edelman has pointed out, the County can practice the same efficiencies and effective management techniques as the most efficiently managed firms. Monopolistic internal services have no incentive to apply those techniques. Application of the principle of competition for resources is the best method available to the County. Giving the managers of County public services the option to choose another producer of support services thus focuses accountability for the public service functions solely on the managers of those functions.

However, in order for this policy to work properly, it must rely on ***fair external competition***. In contrast, during the past year the CAO and the Board have permitted operating departments-Health Services and the Sheriff among them-to take over facilities management and computer services for themselves. By doing so, the individual department can accomplish two goals. First, it eliminates payments to ISD, thus seeming to reduce the cash outlay from the department. This appears to relieve some of the department's budgetary stress. Second, it can tailor the service to meet its specialized needs and can maintain complete internal control over support services personnel, schedules, and performance. The second kind of consideration may be important for the Sheriff and the Department of Health Services. It is important to understand, however, that the County reduces its total County-wide costs only when the transfer of work triggers a corresponding reduction of resources in ISD.

Occasional exceptions may be justified. However, the costs of the individual departments are not necessarily reduced. The appearance of lower cost merely reflects the first year decisions of that department to absorb the management costs within its current organizational structure. Doing so does not mean the costs have vanished permanently. The current savings are an artifact of the County's internal accounting. Further, at some point in the future, departments will require additional management to control the functions. Therefore, eventually, this practice would lead to the creation of duplicative management services in each County department. It would mean increased cost for the County as a whole. It would also mean loss of the specialized skills and knowledge base available in ISD, including standards for public buildings, life cycle costs, and so forth.

In this regard, Richard Dixon argues that the budget is determined more by the allocation of available resources than by financial planning and cost considerations. That is, the cost of an in-house support service will only increase if the Department can absorb the increase in that Department, since the CAO will not be permitting a corresponding increase to cover it. The argument is a valid reason to permit exceptions when justified. We believe, however, that eventually each department would have its own bureaucracy producing and managing its own support services, at a much higher cost to the County as a whole.

Therefore, we strongly urge that the Board should permit exceptions rarely, only upon thorough documented justification, in each instance approved by the CAO and adopted by the Board of Supervisors. When we recommended the current basic policy as adopted by the Board in 1986, we emphasized:

> The CAO should ensure that the savings achieved by use of the option (to choose another supplier) result in ***savings to the County as a whole.***
>
> The CAO should ensure that the use of the option by client departments does not cause a departure from acceptable standards.
>
> The client department must be obliged to seek bids and quotes from ISD on the same basis as from private firms.

Recommendation 3

We recommend that the Board of Supervisors direct the Chief Administrative Officer, the Auditor-Controller, and the Director of Internal Services to design and present to the Board methods of pricing services and charging them which have been agreed to by client departments and districts. The pricing method should be designed to budget ISD at a zero net County cost. The design should incorporate the following features:

- *flexible pricing that results in charges that reflect the differential demands for services and quality levels,*

- *service pricing that includes all ISD costs, including the indirect costs of the department, its management and overhead, and the costs of wage or benefit increases for its employees. However, we urge that ISD find economies and productivity improvements in its department to offset increases in labor costs, thereby avoiding price increases.*

The Board and County departments should treat ISD or its component operations as businesses. They are an in-house alternative to purchasing outside services. Presumably, they are or can be more efficient or effective than available outside services. If they are to behave as outside businesses, then they will recover all their costs from their clients. In labor negotiations, that may force hard choices between fewer jobs and higher pay. In client services, it may force hard choices between high priority maintenance and facility improvements. These choices are precisely the kinds of trade-offs the public expected would be made to respond to a scarcity of tax dollars.

If the competition is to be fair, then ISD must be able to price its services in the same way as an external provider would. That is, ISD will need the proper accounting policies and support systems to permit it to tailor prices to the level and quality of services required. For example, a department purchasing a large volume of ISD services might get lower prices. A client department occupying an office building with little public traffic might be willing to accept minimal standards and pay less. Another might require much higher standards to accommodate significant public traffic.

The point is, ISD should be prepared to behave in the same way as private business. It should respond primarily to demands for its service. Its resources should increase and decrease along with the demands for its services. ISD should respond by improving productivity - for example by reducing overhead costs, modifying supervisory levels, moving to less expensive space, replacing obsolete equipment, adopting more efficient work practices. If the department is unable to finance the cutbacks with productivity gains, this might mean layoff in times of declining resources. On the other hand, it might also create incentives to consider the relationships between the availability of jobs and the level of wages. Until recently, there was little financial pressure required to force examination of the alternatives as part of the collective bargaining process. We support a policy that requires pricing to cover all costs, including wage increases. It may have the unfortunate consequence of occasional layoff. It might also create an economic incentive to preserve jobs through increased productivity.

This is the crux of the issue of layoff. The Director of ISD, William F. Stewart, contends that in this instance the elimination of certain unneeded supervisory positions was done to improve productivity. This caused layoff of several employees and the demotion of others in order to meet the immediate budget deficit. However, the CAO contends that further productivity gains are possible in the Department. Since we have not studied this issue in detail at this time, we cannot conclude whether layoff was the best feasible alternative. Sometimes it is. We emphasize, the primary issue for both management and the employee representatives should be productivity improvement, including the tradeoffs between layoff and wage increases.

SUMMARY

In conclusion, you asked our Commission to reexamine your policy of requiring ISD to be fully funded by its client departments. Layoffs and demotions precipitated the need to evaluate the policy.

We support the current policy. The resources available to ISD should fluctuate according to demands for its services by the departments that use them. We recommend that the Board retain that policy. In addition, we recommend that the Board and County management commit to three goals that would make implementation of the policy more effective. They are:

- Establish programs to soften the impact of layoff on employees when layoff is a necessary response to conditions in the economy.

- Strictly control the use of the option permitting departments to organize their own in-house support services in competition with ISD, and audit such decisions at least every five years.

- Make every effort to permit ISD to use methods of pricing its services that will optimize its competitiveness.

Our Commission is available to assist your Board, the CAO and department heads in finding ways to make this policy work effectively.

Very truly yours,

Gunther W. Buerk, Chairperson

Alfred P. Balderrama

(cwk)

Robert H. Philibosian

cc: Each Commissioner
Each County Department and District Head

Richard B. Dixon
William F. Stewart