CITY OF CHARLOTTE
INTERNAL AUDIT

Guide to Competitive Bidding and Optimization

July 2006 – highlighted 1/4/07

CITY OF CHARLOTTE
INTERNAL AUDIT

Guide to Competitive Bidding and Optimization

I. Introduction

A. Level Playing Field

As provided in the Guidelines For Services Contracting policy statement adopted by the City Council in 1994 (and revised in 1997), the City's Internal Audit Division is required to review in-house bids to determine that the proper costing methodology has been applied.

The City Council defined the phrase "level playing field" as "…one that neither favors nor disadvantages any bidder (including any City department) to any extent over another party." While City management and the Privatization/ Competition Advisory Committee (PCAC) were given the responsibility to assure that specific procedures were in place to establish a level playing field for each bid, the Council provided general guidelines meant to assist in this effort. Those guidelines are entitled:

- Organizing For Contracting
- Content of Requests For Proposals
- Development of Request For Proposals
- Proposal Review, and
- Costing Methodology

B. Working with Internal Audit ("IA")

While each contracting unit is primarily responsible for completing its bid, IA's role as defined by the Council is significant and should be considered during the planning phase. Generally, we request that bids (including the Cost Elimination Plan) be completed 3-4 weeks in advance of the due date (longer, if the bid team requires extra days for printing and binding). In all cases, IA advises the bid team to involve Audit as early as possible so that we may plan sufficient time to support the bid. The PCAC liaison from BSS assists in setting the schedule and will estimate IA review time in the initial draft schedule.

In summary, IA requests that contracting units comply with the following time frames:

- 4 months prior to bid submittal date – notify IA of intent
- 3-4 weeks prior to bid submittal date – final information to IA
- 1 week prior to bid submittal date – all changes should be completed

C. Working with the PCAC

Depending upon the individual contract, the PCAC may be involved with the RFP development and subsequent bid review to varying degrees. The PCAC generally accepts IA's opinion regarding the accuracy of the City bid, but sometimes hires a consultant to provide additional scrutiny and/or specialized technical advice. In those cases, IA will work with the bidding unit and the consultant as required to provide additional verification of the legitimacy of assumptions or the accuracy of cost items as recommended by the consultant.

D. Goals and Benefits of Competition, Optimization and Gainsharing

Managed Competition and Optimization are tools available to the City in order to provide the most efficient service to its citizens at the lowest cost. KBEs and the City Manager's office, along with guidance from the PCAC, decide when and where to implement managed competition.

Competition allows the City to determine whether its use of employees is the most cost-effective approach to providing a service. By giving the private sector an opportunity to bid, the City can best determine how to provide the most value in delivering that service.

Managed Competition requires Internal Audit involvement with the following:

a. Solicitation for proposals to ensure a level playing field;
b. Accuracy of the City's proposed costs for delivering services;
c. Financial reviews of proponents to help determine their ability to perform;
d. Validating the City's actual costs, and any gainsharing; and
e. Compliance with financial and non-financial aspects of service agreements

"Optimization" is the term given to the City's efforts to extend lessons learned through competition to similar operating units. (While it seems reasonable to assume that the lessons learned are "recent," there is no defined period which fits all cases. This document assumes that a decision to optimize has been approved.) Optimization does not require some of the formal steps followed with a Competition; for example, no Cost Elimination Plan is required and no specific PCAC involvement is outlined. Therefore, some conclude that Optimization is easier than Competition. However, the effort required to support a contracting unit's initial budget and subsequent results is no less rigorous. In fact, the lack of a competitive process makes budgets derived through Optimization more difficult to justify.

Gainsharing is available to employees who are members of the contracting unit, whether through Competition or Optimization. Competed contracts allow 50% of the savings to be shared among contract unit employees, while Optimized contracts allow 33% of savings to be shared. (The remaining 50% or 67% is retained within the department, per Council Guidelines.) While the availability of gainsharing is an incentive to employees and contributes to positive results for the City, it should be understood that gainsharing is a side benefit and not a goal. Gainsharing is neither a requirement nor an entitlement. This is especially important when determining an appropriate Optimization budget, whereas the discipline of a Competition tends to keep excessive gainsharing in check.

II. New Budget/Bid

A. Principles of Budget/Bid Preparation

1. To prepare a Competition or Optimization bid (budget), prior actual expenses should serve as the primary guide. While a past budget is of interest, it is often an outdated estimate. Actual expenses from a recent period are a better indication of future expenses than estimates which were prepared 18-24 months earlier. Audited results are preferred but may not be as timely.

2. A budget reconciliation (recent actual expenses to proposed budget) is required, explaining either increases or decreases of each significant line item. Small items need not be explained, but generally, differences greater than <u>either</u> 10% or $10,000 need at least a brief comment. It may be helpful to include one or more prior years of actual expense data to better understand expenditure trends.

   Note: While the simplest approach is to have each contract coincide with the City's fiscal year, this is not required. The second best start date is January 1, while April 1 and October 1 are also acceptable. Any contract with a start date other than July 1 should have an "Initial Operating Period" so that subsequent periods coincide with the City's fiscal year.

3. Operational changes will often result in staffing changes, either a reduction of employees or a substitution of contractors for employees. The actual number of employees pre-bid and post-bid must be reconciled and explained; i.e., the reconciliation should be based upon the number of employees who most currently are producing the services, rather than budget positions which do not reflect current costs.

4. Significant changes in methodology may require formal agreement by others, possibly including IA.
   - For example, a proposed change in the work week may need HR policy review, while IA will need to verify the financial assumptions and predicted impact.
   - For another example, a proposed plan to replace a City support unit with a private contractor may need policy approval from the City

Manager's office. Also, in this second example, HR would need to assist with the determination of employee impact and IA would review the financial assumptions. Any work units which may be impacted by such a change should be made aware of the bid team's plans as early as possible.

5. Supplies (and some services) which are purchased in quantity, or under contract, may require special documentation. When possible, bids should be based upon long-term contracts which will fix the price of items such as chemicals or asphalt (or the specific service). The lack of a contract should be explained, and projections will need to be based upon industry and trend analysis and/or economic forecasts from reliable sources rather than an arbitrary percentage increase.

6. Sometimes a department determines that the timing of a competition or optimization provides an opportunity to update the service level requirement(s) for the operation. While this may be true, the decision imposes an additional requirement upon the bid unit. All of the reconciliations noted above need to be completed on a "consistent service level" basis, and the impact of the service level change needs to be added separately so that each can be evaluated.

7. There may be unique contract provisions which need special treatment. For example, a contract may have a ceiling for certain types of repairs and another classification of repairs (more accurately considered capital improvements) may be treated as "off-budget." In such a case, <u>it is important for the bid to carefully distinguish between the types</u>.

8. There may be other expenses which are not made a part of the budget due to the approach laid out in the RFP. For example, tipping fees for garbage collection are the same for the City and any contractor, so the fee is not bid. Also, some water treatment plants pass through electricity costs for pumping because the operator does not control the volume of inflow.

9. Monitoring costs must be considered. Although it is sometimes thought that a managed competition project must result in additional monitoring costs, the opposite has been found. Whether the City or an outside contractor performs the service, the City will need to monitor that performance. In the case of garbage collection, the same amount of effort is expended to monitor performance, regardless of the provider. For street maintenance, it was determined that Engineering staff would randomly inspect about 25% of the work performed whether City employees or an outside company repaired streets. If the bid unit suggests that there is a difference between required monitoring, this will need to be explained in detail for consideration by management and the PCAC. (The impact of managed competition on "internal monitoring" costs, or administration,

should be considered during the process used to determine whether managed competition is a viable alternative. This determination may need to include consultation with Internal Audit to reach an understanding of what documentation will be required to meet IA's verification requirements. This Guide focuses on the determination of costs used in the bid after the decision to compete has been made.)

B. Line-by-line

1. Personal Services

   a. Direct Labor – The specific employees who will be a part of the contracting unit should be identified, along with their associated labor costs, health insurance, merit and longevity pay, etc. (If a retirement occurs during the period covered under the MOU, note that the payout attributable to accrued leave which existed at the start date will not be charged to the contract.) A possible conflict exists when the bid team uses the labor rates for specific employees who will be transferred into a work group if the City wins, while a different group of employees would actually be terminated or moved elsewhere if the City loses. The bid team will need to calculate both costs and IA will evaluate whether the difference is significant enough to require further analysis.

   b. Pay Raises – The timing of specific employees' pay raises should be considered. See "Merit" below.

   c. Health Insurance – Actual health insurance costs are obtained from PeopleSoft. The use of average insurance costs from the budget and general ledger may vary significantly from the actual costs which the contracting unit will be accountable for when regular audits are conducted under competition. For optimizations, actual costs will be reflected on the monitoring report; however, an adjustment may be made "below the line" to eliminate any gain or loss for which the contracting unit is not responsible.

   d. Payroll Taxes (Social Security & Medicare) – The bid should include 7.65% of expected gross pay for all regular, part-time, or temporary employees. To compute the amount, this factor should be applied to all projected normal wages, overtime, merit pay, longevity, and Recruit and Retain Program payments.

   e. Overtime – If increasing or decreasing beyond historical, explain rationale.

f. 401(k) – The bid should include 3% of expected gross pay for all eligible employees; new employees are not eligible for the City contribution until after 6 months of City employment.

g. Merit – Include in the bid's first year an estimate of each employee's merit pay, based on the City's Budget Office guidelines and the employee's merit date. For the bid's later years, increase by a percentage the first year's projected combined merit totals for all employees, as well as beginning-of-year base pay totals. The percentage should be based on the most recent guideline from the City's Budget Office.

h. Temporary Pay – As with Overtime pay, if increasing or decreasing beyond historical, explain rationale.

i. Workers' Compensation – Follow the guidelines, calculation methodology, and premium rates provided by Finance's Risk Management Division each March. Such rates will be charged to the bid unit until the next year's rates are released. As for later years, ask for the Division's advice as to whether the bid unit's loss experience appears to favor future increases or decreases in premiums, and the magnitude of such changes. Base the later year estimates on that loss experience. Optimizations differ from bids in the handling of workers' compensation, due to the nature of risk and reward. Optimizations do not gain or lose savings from workers' compensation, as adjustments for such premiums are made yearly to the optimization budget.

j. Longevity – Include these ongoing payments in the bid for each year unless an individual is expected to retire. The payment amounts are frozen, so no increase for later years is necessary.

k. Retirement – For the City's share of this benefit, include 4.8 percent of gross pay for eligible employees.

l. Recruit and Retain – Consider the bid unit's past experience and obtain HR's advice regarding future availability of this fund, estimating an amount to reasonably cover expected payments. Note that the continuation of this program is not guaranteed.

m. Incentive Pay – There may be a citywide incentive plan in place during part or all of the contract. These costs cannot be anticipated and IA believes that they should not be a part of the bid. If incurred, they will not be charged to the contract.

2. Equipment

   a. Capital Expenditures – While some contracting units simply continue using existing equipment when beginning a new MOU, it is not unusual for a bid to be based upon the presumption that an existing fleet will be replaced in part or in whole. If a large capital investment will be required, the bid unit needs to coordinate early with Budget & Evaluation (B&E) to determine whether funds will be available to meet the bid needs. (Both primary equipment and reserve must be considered, i.e., the bid unit must propose all pieces of equipment to be used in performing the contract and determine whether reserve equipment will be purchased new, or be composed of older equipment already in use.) It may be necessary to present a business case to explain the capital needs and the benefit of reduced maintenance (for example) which will result in savings to the City overall. Also, <u>the bid should be based upon firm contract prices which are obtained prior to bid submittal and which will be valid through the period when the equipment would actually be ordered</u>.

   b. Cost of Capital Rate – For existing equipment, use a cost of capital interest factor (provided by the Finance Department) that corresponds to the fiscal year in which the item was purchased. For a new purchase, once the purchase of equipment has been approved, the known or projected rate of interest must be obtained from Finance, based on the specific fiscal year pool of lease-purchase funds that B&E agrees can be utilized. Attempt to "lock in" an existing financing rate if current or prior years' funding pools have remaining balances. Otherwise, depending upon the timing of the bid, Finance may not have negotiated the actual rate of interest which is required to fund the bid unit's purchase. The bid unit will need to make its best estimate, based upon prior year rates and recent trends.

   c. Depreciation and Financing Cost Calculation – To determine the amount of depreciation and financing cost which will be charged to the contract each year, four variables must be known or estimated.

      - Price should be obtained by contract.
      - The useful life of the equipment will likely vary from the "accounting life" used by Finance and made a part of the City's financial statements. For purposes of the contract, the bid unit should estimate the actual life that the equipment will be utilized. When a contracting unit will be using equipment that is already in service, it will need to carry forward the remaining life if the equipment is currently involved in a competition/optimization.
      - Once it is determined that the equipment will be used for a certain period, salvage value is estimated with the assistance of EMD's

Surplus Property Manager. In most cases, the City sells similar equipment on a regular basis and will use this information to project future auction proceeds.

Consideration should be given to the expenses related to the auction when calculating the salvage value of the new equipment. The auction expenses include the commissions, cashier services, advertising expenses, and any reimbursed expenses (batteries, tires, duplicate keys, removal of graphics, and security services). The contracting unit will need to consult with BSS to find the average expense percentage of gross receipts. In the past, the expenses have ranged between 10% and 14% of the gross auction proceeds. Therefore, salvage values to be used in calculating the capital financing for the equipment should range from 86% to 90% of the anticipated gross auction price.

- The cost of capital interest factor discussed in 'b' above is the final variable.

For the calculation, the "Payment" function in Excel can be utilized to determine the yearly charge that includes capital and financing costs. To that yearly amount, add one year's interest on the salvage value. Internal Audit can provide examples if necessary.

It may be necessary to separate the cost of capital from the depreciation charge. In some cases, equipment is obtained several months before being placed in service. Since the City's costs begin on the day it pays for the asset, the bid unit must assess the interest charge from the payment date. However, depreciation begins on the date the equipment is placed in service. (An acceptable approach is to capitalize the pre-contract interest, then depreciate that cost with the other asset costs over the estimated life.)

d. Disposal of Assets – When new equipment is purchased, old equipment is disposed of by transfer or sale. (See Cost Elimination in section III.B. below for discussion.) Usually, the old equipment is sold at public auction through BSS. For equipment that had been included in the bid cost proposal, after the auction results are known, the contracting unit will need to determine whether any gain or loss was realized. This gain or loss will be added to or deducted from the current quarter's monitoring report.

3. Other Operating Expenses

a. Fuel – Fuel projections must be made based upon recent history, trends, and operational considerations for the future. For example, a change in expected mileage, equipment type, age or number of pieces, or type of motor fuels used could result in significant alterations from the current trend. If fuel is a significant part of the contract (say, 10% or $100,000), it is likely that a fuel adjustment clause will be incorporated into the RFP and MOU. The bid unit still should make its best estimate because typically, prospective adjustments are made to the contract 3-6 months after the fact, and are limited to cost variations above or below the existing fuel cost when the contract is bid. Use of the fuel adjustment clause allows the bid unit to focus on quantities of fuel more than fluctuating market rates. (IA also advises that the RFP provide for an adjustment as of the contract start date if criteria are met.)

b. Vehicle Maintenance – Historical costs provide the initial point of consideration. However, significant changes to projections may result from any changes in equipment. New types or versions of even similar equipment can impact preventive and scheduled maintenance requirements. In addition, changes in operational assumptions must be considered, including the impact of annexations, scheduled hours of operation, adequacy of reserve equipment, etc. The contracting unit must work closely with BSS' Equipment Maintenance Division to determine a reasonable estimate of costs. The bid unit should closely review its past preventive and routine ("target") and customer directed "non-target" costs (e.g., additions, deletions, accidents, operator abuse) and determine whether the same level of work will be desired.

c. Radios – While the initial purchase of radios is addressed as equipment, above, continuing operational charges should be considered. There are access charges, and regular maintenance may be required. The BSS Radio shop should provide guidance regarding projected costs.

d. Facilities – The RFP will indicate how facilities will be considered in the bid. The RFP will indicate that either the bidder "must," "may," or "cannot" use the City's facilities and the costs the bidder will be responsible for, if any. The KBU must be prepared to address how existing facilities will be used if the service is contracted out. The cost of facilities may not be considered "go-away" if the City needs to retain the facilities as backup, i.e., in the event the KBU could be required to restart its operations in the near future.

e. Unique Costs – There may be other expenses unique to contracting units which are not addressed above. For example, there may be special supplies, rental equipment, temporary agencies, travel expenses, or services provided by other City cost centers. Estimates for these must be prepared on a case-by-case basis. However, the principles are similar to many others. That is, historical costs provide the starting point for projecting future costs. Changes in operations or market prices provide a basis for adjusting projections.

f. Inventory – For supplies with significant dollar values, a beginning inventory will need to be established to avoid penalizing or benefiting the contracting unit for periodic fluctuations of these materials, chemicals, etc. and for later comparisons to ending inventory at year end. Similar to facilities, it is possible that a bidder may be required to use the City's inventory of parts or supplies. The bidder is responsible for replenishment costs to maintain the inventory level. Alternately, the City may need to reflect the cost of re-stocking (returning inventory to suppliers for a fee) in the Cost Elimination Plan. If inventory is significant, the City may need to determine the value ("go away costs") of eliminating the need to maintain a parts or supply inventory. (Note: If given the option and if a private bidder elects not to use the City's existing inventory, the estimated net auction proceeds may be considered a "transition cost" to be deducted from the private bid.)

4. Contingencies

Unless the RFP specifically defines a contingency line item, there is no provision for such an unclassified expense. The bid team will naturally evaluate each line item and strategically determine whether to bid "tight" or "loose," based upon past experience and best forecasts. That is, salary costs may be projected with great accuracy, while health insurance and vehicle maintenance costs, for example, may be projected to fall within a wider range. In all cases, Internal Audit will evaluate the reasonableness of the estimates using historical trends, guidance from Budget & Evaluation and other key support businesses, and responses to inquiry of the bid team's assumptions.

5. Liability Insurance (Vehicles and General)

In the past, City contracting units have used Risk Management's adjusted premiums and risk factors to determine applicable costs to include, considering that the City self-funds a large amount of risk and re-insures for extraordinary losses. Going forward, bids should continue to follow this methodology. However, contracting units and the bid team should be aware that IA may recommend that the evaluation of risk, and the associated costs, be performed differently in the future. That is, with the realization that the City remains at risk for extraordinary events, regardless of whether City employees or a contractor provides the service, we need to make sure that a cost comparison does not incorrectly assume an inappropriate level of cost reduction would result from contracting with a private company. Since this perspective has not been addressed recently, it will need to be considered on a case-by-case basis going forward. As with workers' compensation, optimizations do not gain or lose savings resulting from differences in actual and budgeted rates.

C. Overhead

1. Source of information – Overhead is assigned to a bid as a series of components. A bid unit must separately determine the portion of Citywide, Departmental, and Division overhead which is applicable to the group of employees covered by the bid.

   a. City – The Budget & Evaluation KBU calculates City overhead annually. A Cost Allocation Plan is produced to assign costs to KBUs or divisions, which may need to be further allocated among the KBU's various components. Most City overhead costs will be classified as "fixed." (Fixed, Semi-variable, and Variable are discussed below.)

   b. Department – The bid unit operates within a Department which will also assign overhead to the bid. Classifying a Department's overhead as Fixed, Semi-variable or Variable is one of the more difficult judgments. To determine the proper allocation, the bid unit must accurately reflect what changes would occur to the overhead's expenses if the activity was contracted out.

   c. Division – The bid unit may make up an entire Division, or may be only a portion of a Division. Like departmental overhead, the bid unit must determine what impact the loss of the activity would have on its overhead components as a method to classify the costs, as described below.

2. Types of overhead – Each of the three overhead categories above can be broken down into one or more of the following types.

   a. Fixed – these are costs that will always remain, regardless of whether City employees or an outside contractor performs the activity. For example, the allocated costs of the mayor and council, along with the City Manager's office are considered fixed for the purposes of all bids.

   b. Variable – these costs can be considered direct, or "attached" costs. That is, the costs exist as long as the activity is performed by City employees. If an outside contractor took over the activity, this type of overhead would no longer exist. For example, the office space including utilities for support staff would likely become unnecessary if all the activities which those employees supported were outsourced. (However, it would be necessary to make sure that the space could be used and the costs could be transferred to another department.) Another example is a stockroom employee who was considered overhead. If all the activities supported by the stockroom were outsourced, this employee would no longer be needed as support.

c. Semi-variable – these costs are more difficult to define and distinguish. They can be explained in context of an activity that is broken into three or four geographic districts. If one of the districts was contracted out, the need for this type of overhead would continue. However, if two or more districts were contracted out, some of this overhead could be cut. For example, a supervisor whose duties were considered overhead might be involved with all four existing districts. If one district was contracted out, the supervisor would continue performing the same work, but would be confined to less territory. However, if three-fourths of the activity was contracted out, the supervisor might no longer be required and his duties for the remaining district might be assigned to another existing person. At each extreme, the concept of semi-variable costs can be easily understood. In between, judgment is required to assign overhead to the bid in a way which accurately reflects the activity, and its costs. While semi-variable costs are usually exempted from the bid, the classification of these costs provides a more complete picture of the potential impact of contracting out.

D. Annual Increase Projections

1. The starting point for making projections is to review historical trends. The focus should be on actual costs, rather than past budgeted costs. If there are wide variances between budgets and actual in the past, the bid team needs to understand the reasons. If some line items are particularly difficult to predict due to uncontrollable circumstances, such as chemicals in a wastewater treatment plant which vary based upon rainfall and the quality of inflow, the bid team should recommend an alternate approach to the RFP early in the process.

2. There may be special circumstances which invalidate past experience as a predication for future trends. The bid team should be prepared to explain these to the auditors. Examples include service level changes, significant position reclassifications and new regulatory requirements.

3. The bid team cannot simply rely upon an annual CPI change. Each line item must be individually analyzed and projected for the entire length of the contract, including possible extension years. It is unlikely that salaries and health insurance will increase at the same rate, for instance.

4. There may be certain line items which the bid team does not have much control over. For example, the bid team is a small unit within a large group of City employees which determines the health insurance costs. However, this does not change the necessity for the bid unit to make estimates (with guidance from HR and B&E), and live with the results, similar to the circumstances that a private bidder faces when it prepares a budget. (As addressed elsewhere, extraordinary circumstances could result in an approved change order; however, the bid unit should not rely upon that possibility.)

5. An Optimization "bid" is handled differently than a Competition. While a competed bid must make firm, multi-year projections, an optimization may be allowed to start with only one or two budget years determined in advance. The rationale is that a Competition imposes the same restrictions on the City as an outside bidder, while the goal of an Optimization is to apply lessons learned from competition to other similar organizations within the City. The Optimized Unit maintains the ability to adjust its budget as circumstances change (with KBU and Internal Audit approval). The goal is to allow employees to be rewarded for efficiencies in areas over which they have significant control while limiting exposure in areas they have less control. The likely result of an Optimization in comparison to a Competition is that the optimized unit's actual expenses will more closely track its budget, which is adjusted each year based on the MOU-specified methodology. That is, there will be fewer opportunities for savings and less exposure to losses. In comparison, the competing unit has validated its budget by exposing itself to competition. Subsequent operational changes which result in efficiencies will be reflected in contract savings and gainsharing opportunities. Inefficiencies will be exposed as contract losses.

6. While there is no "one" way to set an annual optimization budget, one approach which should be considered is to average the three prior years and adjust the resulting amount for significant operational changes (on a line-by-line basis, not the entire budget as a whole). In an environment of continual improvement, this formula will result in a downward cost trend without undue penalty to the contracting unit for recently obtained efficiencies.

III. Cost Elimination Plan

While this plan is a separate document (not required for optimizations), it is equally necessary to the proposal and must be submitted at the same time as the bid. To accurately determine and compare the costs of performing an activity in-house versus contracting out, the impact of displaced employees and the revenue which may be obtained by disposing of equipment must be considered. For example, the

City's choice between two otherwise equal bids (i.e., City and outside contractor) would be impacted by significant severance pay due if employees were terminated, and/or by the opportunity to sell unneeded equipment.

A. Employee Impact – The costs in this area negatively impact the benefit which would otherwise be obtained by contracting out the activity. (That is, the cost of employee displacement could exceed the savings which might otherwise be available by contracting out.) If employees cannot be placed elsewhere in the City, the KBU will incur costs of severance pay, accrued vacation, and unemployment claims. The following issues should be considered in making a determination of total employee impact costs.

1. Placement – the contracting unit must consult with Human Resources to help determine the likelihood of placing employees elsewhere in the City. The first consideration is the existence of other positions within the contracting KBU. Since it may be several months from the contract award date until the start date, turnover and voluntary retirements should be considered. HR will be able to determine what similar positions exist in other KBUs. If the contracting KBU has previously competed and lost, it will have historical information of placement percentages. However, if other areas of the bidding unit have already been outsourced, there will be fewer positions available for placement.

2. Severance Pay – Those employees who must be terminated will be paid one week of severance pay for each year previously employed by the City, according to the City's Council-approved policy. The Plan must project the hourly wages of each employee who may be impacted, including merit increases scheduled to occur before the contract start date. The bid unit should prepare a schedule detailing these calculations and including the employment start date of each person within the unit.

3. Vacation Payout – At termination, employees are paid a lump sum equal to the value of their accrued vacation. While actual vacation balances at termination will vary from the balances available when the bid and plan are prepared, the most current balances are reasonable estimates of future balances, unless the contracting unit is aware of plans contrary to this assumption. No calculations are necessary to address "comp time" because comp time is usually not paid out. If such payment is proposed, it should be discussed with HR.

4. Unemployment – The City does not contest terminations when employees are laid off. Therefore, the City is required to reimburse the Employment Security Commission at 120% of actual claims. Estimated wages are used to compute reimbursable claims, considering the State's maximum weekly payout and timeframe. Also, the contracting unit must project the number of laid off employees who will file a claim. While assumptions will vary based upon the type of jobs impacted and current economic conditions, the following data from a 2004 Cost Elimination Plan may be of assistance:

- State maximum of $416 per week
- State payout limited to 26 weeks
- One KBU estimated that two-thirds of the terminated employees would file claims

B. Equipment Disposal – Whether the bid unit wins or loses, it may plan to dispose of a portion or all of its existing vehicle fleet or other equipment. Estimated revenue to be derived by the City from disposing of all its current equipment is considered in bid comparisons as a reduction of the private bidder's costs. The City's bid is reduced by the revenues derived by selling just the unneeded vehicles. Whether the equipment is sold at auction or transferred to another City division, the Cost Elimination Plan should reflect the value of the equipment (as revenue or expense reduction). While the bid unit may not consider a transfer as a revenue producing activity, the effect is to reduce the costs to another division which would otherwise be purchasing similar equipment. The contracting unit should obtain estimates of revenue which could be derived from the sale of the equipment, after projecting the age and condition of the equipment which would be sold.

C. Transition Costs – Either a win or a loss could result in transition costs unique to the service under competition. In the past, such costs have included the following:

- Computer training for an outside contractor required to use the City's systems
- Drivers' training for City employees who will begin using new equipment if the bid unit wins the contract

IV. Change Orders

Extraordinary circumstances or volatility of certain materials may result in significant price changes from the original bid or optimization projections. In such cases, contracting units may request a change order. Before requesting a change order, the contracting unit should consider the following:

A. Change orders are not automatic. There is a substantial burden of proof on the contracting unit to justify the change order, even if significant price changes have occurred. The facts and circumstances around the change would be considered on an individual basis.

B. Contracting units operating under competition and optimization agreements will be treated as much like an outside vendor as possible. Any allowable changes would need to conform to guidelines specified in the contract.

C. A "threshold" may be established so that an adjustment can be considered if costs vary more than a determined percentage from original projections.

D. Beneficial effects of previous price decreases will be considered when a subsequent price increase is used to justify a change order request for relief.

Note: This document reflects the opinion of Internal Audit staff and may be revised or updated periodically. Internal Audit does not have the authority to create or determine any official policy of the City of Charlotte. Any questions regarding this document or its interpretation should be directed to the City Auditor.