FOLLOW-UP REPORT
Privatization Practices Audit
July 2017
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Report year: 2015
July 6, 2017

Honorable Michael Hancock, Mayor
City and County of Denver

Re: Audit Follow-Up Report

Dear Mayor Hancock:

In keeping with generally accepted government auditing standards and the Audit Services Division’s policy, as authorized by D.R.M.C. § 20-276, our Division has a responsibility to monitor and follow-up on audit recommendations to ensure that audit findings are being addressed through appropriate corrective action and to aid us in planning future audits.

This report is to inform you that we have completed our follow-up effort for the Privatization Practices audit issued June 18, 2015. Our review determined that the Budget and Management Office (BMO), to which the Mayor’s Office delegated implementation activities, did not fully implement the three recommendations that were made in the audit report. Although no new privatization activity has taken place since the audit was released, the framework that BMO agreed to implement has not been completed. Therefore, auditors determined that the risk associated with the audit team’s initial findings has not been fully mitigated. As a result, the Division may revisit these risk areas in future audits to ensure that appropriate corrective action is taken.

For your reference, this report includes a highlights page that provides background and summary information on the original audit and the completed follow-up effort. Following the highlights page is a detailed implementation status update for each recommendation.

This concludes audit follow-up work related to this audit. I would like to express our sincere appreciation to you and to the BMO personnel who assisted us throughout the audit and follow-up process. If you have any questions, please feel free to contact me at 720-913-5000 or Dawn Wiseman, Audit Manager, at 720-913-5069.

Denver Auditor’s Office

Timothy M. O’Brien, CPA
Auditor
Privatization Practices
July 2017

Status
The Mayor’s Office delegated to the Chief Financial Officer and the Budget and Management Office the responsibility of implementing the recommendations that resulted from our audit of the City’s privatization practices. Of the three recommendations made in the June 2015 audit report, one has not been implemented and two were partially implemented.

Background
Privatization practices vary across all levels of government, and include asset sales, public-private partnerships, and outsourcing. Proponents believe that privatization can provide higher quality goods and services at a lower cost, but this assertion is still under debate. The success of privatization functions hinges on several key characteristics, including high level of market competition, well defined service quality measures, transparency and accountability of private sector service providers, and the protection of employees. Within the City, several agencies have privatized functions, either in whole or in part. Applicable guidance for these agencies can be found within Executive Order 8 and the City’s budget process.

Purpose
The objective of the audit was to evaluate Citywide practices regarding privatization, including:

- Decision-making processes
- Performance monitoring techniques

Highlights from Original Audit

Due to a lack of clear guidance established by the City and County of Denver (City), the audit team could not assess the magnitude or cost effectiveness of the City’s privatization practices. Agencies were inconsistent, both during the initial decision to privatize a government function and when conducting performance monitoring for a privatized function. The lack of a sound privatization framework led to potential risks including increased costs, improper monitoring and oversight, and, ultimately, irresponsible use of tax dollars.

The audit team used a variety of resources when examining aspects of privatization from all levels of government, trade and advocacy organizations, and academia. We found that best practices support using a robust decision-making process, including performing a comprehensive cost-benefit analysis, prior to privatizing any government function. Subject matter experts also advocate for performance monitoring to inform future privatization decisions.

The original audit revealed that agencies and departments often did not follow these best practices. For example, Public Works privatized a portion of its Critical Sanitary Sewer Replacement program. Based on a cost comparison conducted on a sample of invoices, the audit team found that Public Works spent an additional $73,407 utilizing a private sector company rather than completing work internally. Other privatization examples included janitorial services, employee assistance programming, and the Better Denver Bond Program.

Findings at Follow-up

A Citywide privatization framework has yet to be fully implemented. Although BMO has created a policy to incorporate analyses used in making decisions to privatize a City function, the policy lacks specific dollar amounts and has not been disseminated to all agencies. Initially, BMO did not report on privatization activities for the budget year, as recommended. However, in an effort to create transparency regarding privatization practices, BMO provided a temporary reporting solution until they are able to fully implement the recommended privatization practices in future budget cycles.

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Or contact the Auditor’s Office at 720.913.5000
## Recommendations: Status of Implementation

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<td><strong>FINDING: The City Lacks a Sound Privatization Framework and Cannot Demonstrate the Benefit of Privatized Functions and Services</strong></td>
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| **1.1** Privatization Framework—The Mayor should develop a framework for all City privatization activities that includes the following elements:  
  1.1.1. Cost-Benefit Analysis completed prior to making the decision to privatize  
  1.1.2. Establishing qualitative and quantitative performance measurements to be included in contracts  
  1.1.3. Contract monitoring requirements that include annual cost and performance evaluation  
  1.1.4. Reporting requirements to monitor and evaluate performance  
  1.1.5. Training for agency personnel involved in the contracting process | The Budget and Management Office (BMO) has developed a Cost-Benefit Analysis template, which includes sections for Cost Analysis, Performance Measures, Qualitative Assessment, and Monitoring. BMO added a procedure to the 2017 Budget Manual requesting that agencies contact them prior to considering privatization. However, the policy that BMO drafted on privatization only partially reflects their initial agreement to the recommendation. Specifically, BMO’s policy definition of privatization excludes the partially privatized functions. Additionally, BMO’s policy does not contain specific criteria to which they had committed in their audit responses, such as dollar thresholds and length of time the functions could be outsourced or privatized. Further, the policy only addresses BMO’s involvement in privatization practices while the recommendation applied to all privatization contracts Citywide. Finally, auditors received no evidence that the policy was disseminated throughout the City or that training on the privatization policy was provided to agencies, although we did confirm that the policy was included in the 2018 Budget Manual. | Not Implemented  
Original target date for completion: 90 days (September 2015)|
## Recommendations: Status of Implementation

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<td>1.2 Reporting and Evaluation—The Mayor should leverage the Budget and Management Office (BMO) to ensure that agencies are implementing the privatization framework and ensure agencies are reporting on privatization activities. BMO should receive the annual contract evaluations to inform future budgetary decisions and to demonstrate if the privatized function provided the City with the intended benefits.</td>
<td>BMO did not report on privatization activities for the budget year following the audit because they did not process any contracts considering privatization under their proposed framework. However, annual reporting on privatization is not contingent on the number of contracts received; it should also provide information on other qualitative factors that would guide future decisions. After discussions between the audit team, BMO, and the Department of Finance, it was determined that reporting will take place regardless of the number of privatization contracts received for that budget year. For the most recent budget cycle, BMO used a temporary reporting solution, since it was too late in the budget year to formally incorporate it into the budget book. BMO officials have committed to doing so formally in future budget cycles.</td>
<td>Partially Implemented</td>
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<td>1.3 Transparency—The Mayor should report annually on the activities of privatized functions to City Council, in alignment with the Mayor’s 2015 priority to deliver the highest quality service at the lowest possible cost and the goals of the Transparent Denver initiative.</td>
<td>This recommendation is contingent upon the full implementation of Recommendation 1.2. Since BMO did not fully incorporate a privatization report into the budget process in accordance with Recommendation 1.2, the Mayor could not report on it to City Council, as requested by this Recommendation 1.3. However, BMO and the Department of Finance (DOF) offered, as a temporary solution, to enhance transparency regarding privatization practices for the most recent budget year. Specifically, a privatization disclosure for the recent budget year was added to DOF’s website. According to the Chief Financial Officer, reports for future budget years will be reported on by the Mayor to City Council.</td>
<td>Partially Implemented</td>
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Original target date for completion: September 2015 (for some), but most September 2016.
Conclusion

A privatization framework has yet to be fully implemented as a comprehensive policy that could be applied Citywide. The Privatization Practices audit was initially directed to the Mayor’s Office because of its Citywide nature. However, the Mayor’s Office delegated the responsibility of implementing the audit recommendations to the Chief Financial Officer (CFO). The CFO, in turn, delegated implementation to the Budget and Management Office (BMO) Director. The BMO Director did create a privatization policy, but it can only be applied in a limited capacity that aligns with BMO’s scope of authority.

BMO’s privatization policy includes some elements of the framework agreed to in the audit, including a template for performing a cost-benefit analysis and performance measures to be included in contracts for privatized functions. However, the policy does not include three other elements of our suggested framework: contract monitoring activities, reporting requirements, and training. Additionally, BMO has not utilized or tested the policy to determine whether it will achieve the results intended by the audit. According to BMO, no agencies submitted an official privatization proposal for the 2017 budget cycle and, accordingly, management considered the agency exonerated from testing the policy. However, if they had truly embraced the spirit of the audit recommendations, BMO could have performed analyses on existing contracts for privatized services to establish a baseline for future privatization contracts in future budget cycles.

Based on our audit follow-up work, we concluded that the first audit recommendation was not implemented; the other two were partially implemented. Further, auditors determined that the risk associated with the audit team’s initial findings has not been fully mitigated. As a result, the Audit Services Division may revisit these risk areas in future audits to ensure that appropriate corrective action is taken.

On behalf of the citizens of the City and County of Denver, we thank staff and leadership from the Mayor’s Office, the Chief Financial Officer, and the BMO Director for their cooperation during our follow-up effort and their dedicated public service.