

# THE STATE'S OFFSHORE CONTRACTING

## ***Uncertainty Exists About Its Prevalence and Effects***

### **Audit Highlights . . .**

*Our review of the extent of the State's offshore contracting revealed the following:*

- No current state laws or regulations address the use of offshore contracting, making it difficult to judge the prevalence and effects of offshore contracting.***
- Our analysis of the limited survey data suggests the State is spending little on services performed offshore:***
  - ***Thirty-nine entities responding to our survey reported 185 contracts totaling \$689.9 million where at least some portion of the work was possibly performed offshore.***
  - ***For 109 of these contracts totalling \$349 million, respondents estimated that only \$9.7 million (2.8 percent) was for services performed offshore but could not provide an estimate for the remaining 76 contracts.***
- The offshore contracts we reviewed generally contain provisions to protect sensitive and confidential information from disclosure.***

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### **REPORT NUMBER 2004-115, JANUARY 2005**

The Joint Legislative Audit Committee (audit committee) directed us to examine the extent to which state-funded work is being contracted or subcontracted out of the country. Specifically, the audit committee asked us to review any Department of General Services' (General Services) policies and procedures relevant to offshore contracting (offshoring) and directed us to survey selected state agencies to identify those that have, or are most likely to have, contracted for services offshore during the previous three fiscal years. Further, for a sample of those agencies identified as having contracts for services offshore, the audit committee asked us to review and evaluate the agencies' policies and procedures for offshoring, including how the agency protects against the disclosure of sensitive and confidential information.

#### **Finding #1: State agencies receive no guidance on offshore contracting.**

State agencies currently receive no guidance related to offshoring and are not required to track where their contracted services are being performed or report the extent to which services are being performed offshore. As the State's contracting and procurement oversight agency, General Services oversees state purchasing, approves contracts for services, and sets contracting policies for the State. According to General Services, neither the State Contracting Manual nor any current state law or regulation specifically addresses the use of offshore contracting, the practice of subcontracting portions of a contract offshore, or the issue of determining where contracted services are performed. This lack of guidance can result in inconsistency in contract provisions among state agencies and makes it difficult to judge the effects and prevalence of offshoring.

We recommended to the Legislature that if it desires information and data on offshore contracting of state services to be more readily available, it may consider granting General Services the authority to require contractors to disclose, as part of their bid on state work or during performance of the contract, details on any and all portions of the project that subcontractors or employees outside the United States will perform.

- ☑ *Proposed legislation designed to place restrictions on and limit offshore contracting could face legal challenges or have unintended consequences.*
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***Legislative Action: Legislation vetoed.***

During the 2005–06 session, the Legislature passed Assembly Bill 524 that would have required all successful bidders on state services’ contracts to complete a questionnaire and report on the portions of the contract that would be performed by subcontractors or employees outside of the United States. The governor vetoed the bill on September 29, 2005.

**Finding #2: The extent of state entities’ offshore contracting remains unclear.**

Our survey of selected state agencies and campuses (entities) gives a limited understanding of the extent of these entities’ offshore contracts because, as mentioned earlier, state agencies are not currently required to collect or track data on state-funded services being performed offshore. Because of the difficulty in identifying where subcontracted work is performed, capturing with any certainty the amount of state funds spent on services performed offshore is a challenge. However, from our limited data, the State apparently has been spending little on services performed in foreign countries.

Specifically, we surveyed the 35 state agencies with the largest dollar amount of contracts for certain services and the five University of California campuses with medical centers about their use of offshoring. These entities reported 185 contracts totaling \$638.9 million in which at least some portion of the work has possibly been performed offshore. Asked to estimate the dollar amount of these offshored services, entities reported that they did not know the amount for 76 of these contracts. For the remaining 109 contracts, totaling \$349 million, entities estimated that only \$9.7 million (2.8 percent) of the contracted services were performed offshore.

**Finding #3: Previous efforts to determine the prevalence of offshoring also yielded limited results.**

Three other organizations that tried to determine the prevalence of services contracted offshore also produced limited results. Specifically, General Services, in response to a February 2004 legislative directive, provided documentation detailing all the internal contracts it entered into that had work performed out of state or out of the country. General Services found that when contractors’ specified work was performed offshore, the degree of offshore work was not always apparent. According to General Services, such data is extremely difficult to gather because the State currently has no requirement for state agencies to collect and track any offshore information. Additionally, a nonprofit corporate research company claims that most states cannot estimate the total amount or value of state contract offshoring because most state governments do not know where service work they contract

out is performed. Finally, the U.S. Government Accountability Office concluded that although there are anecdotal accounts of state governments using offshore contracts, no comprehensive data or studies of the extent to which state governments use these contracts are available.

**Finding #4: Contract provisions related to subcontracting are not consistent among entities.**

Our survey results show that state entities are inconsistent about including contract provisions related to subcontracting, delegating, or assigning contract duties. Specifically, we asked survey participants if their general contract provisions prohibit any or all of the contracted services to be subcontracted, assigned, or delegated. Eleven of the 39 entities responding reported that they generally prohibit any or all services from being subcontracted, assigned, or delegated. Another 24 responded that their contract provisions generally do allow for services to be subcontracted, and the remaining four entities did not respond to the question. Of the 24 entities that generally allow for subcontracting, four reported that their contracts generally do not require the contractor to notify the agency when subcontracting services. However, when entities do not require such notification, they are unaware of who is providing the services, making it difficult to effectively manage the contract.

**Finding #5: Offshore contracts generally contain provisions protecting confidential information.**

The offshore contracts we reviewed generally contain provisions to protect sensitive and confidential information from disclosure. Current state and federal laws protect an individual's confidential information, such as medical records, from disclosure. Of the 185 contracts that state entities reported as having at least some portion of the work performed offshore, we identified 11 contracts in which the contractor has access to confidential information. All 11 of these contracts contain, at a minimum, general terms that prohibit the contracted parties from disclosing sensitive and confidential information, and some specifically describe the contractor's responsibility in protecting this information. Nine of the 11 contracts allow the State to terminate the contract if the entities consider the contractor to be in material breach of the terms and conditions, including those protecting sensitive and confidential information. Finally, nine of the 11 contracts include a provision dictating that the governing law of the contract shall be the laws of the State.

General Services requires state contracts to include standard terms and conditions that subject the contract to the laws of California, including those related to confidential information, and that impose liability on the contractor for all actions arising out of the contracts. However, it is important that all parties to the contract, including all subcontractors, either domestic or offshore, are aware of these standard terms and conditions and comply with them.

**Finding #6: Legislative attempts to restrict offshore contracting raise serious legal concerns.**

The federal government and 40 states, including California, have proposed or adopted legislation to restrict offshoring. These include laws that would prohibit all contracts in which work is performed offshore, provides preferences to state or local vendors, require that state contracts detail and report all services performed offshore, and require disclosure if contractors send sensitive or confidential information offshore. Existing research indicates that state efforts to

restrict offshoring may violate constitutional provisions allowing the federal government to set uniform policies for the country as a whole in dealing with foreign nations. Also, restricting or limiting offshoring may invite retaliatory trade sanctions against the United States. Before proposing measures to restrict offshoring, policymakers need to consider whether such actions are both legally sound in the United States and capable of withstanding international legal challenges.