

## **6.1 PRIVATE SECTOR CORRECTIONAL INDUSTRY PROGRAMS**

### **1. INTRODUCTION**

This policy formalises the basis on which CSI will enter into contractual arrangements with the private sector. The policy includes:

- discussion of the contractual requirements relating to private sector correctional industry programs;
- the selection and evaluation of private sector proposals;
- the operation of private sector correctional industry programs.

Private sector involvement in Correctional Industries can take many forms. In its most diluted form, it simply involves the sale of CSI products and services to the private sector. The most pure form of private sector Correctional Industry is the complete management and operation of a correctional industry by the private sector.

The various levels of private sector correctional industry are:

- Level 1: Private sector management and operation of business unit.
- Level 2: Business unit dedicated to a private sector organisation with private sector managerial support.
- Level 3: Subcontract work – continuous basis.
- Level 4: Subcontract work - ad hoc basis.
- Level 5: Sale of Corrective Services Industries products or services to the private sector.

The introduction of private sector correctional industry in New South Wales evolves from:

- (a) Reducing the scale of the Public sector by providing the private sector opportunities to manage and operate traditional public sector functions.
- (b) Minimising public infrastructure required to manage and operate correctional industries.
- (c) Fulfilling correctional industry policy objectives by providing genuine work responsibilities to inmates as a basis of enhancing post release employment opportunities.
- (d) Maximising the opportunity for correctional industries to contribute positively to reducing the cost of managing Corrections.

The dimension of Corrective Services Industries productive capacity is such that traditional market access provides inadequate market opportunities. Access to private sector correctional industry market opportunities is therefore a non-optional operational reality.

All new CSI business units are therefore to be offered for private sector involvement. Concurrently with this process conventional Corrective Services Industries business units will be offered for private sector involvement on a programmed basis.

In the application of this policy, CSI staff are to refer to the requirements of section [1.8 Corruption Prevention](#) which includes the document "Probity and Corrective Service Industries" issued by the Commissioner of Corrective Services.

It is stressed that business evaluation cannot always be performed according to prescribed rules and formulas. Corrective Services Industries staff are to be aware that there will be many cases where other techniques are warranted. In this regard, where required, the assistance of the CSI Commercial Manager is to be sought.

## **2. SELECTION OF PRIVATE SECTOR CORRECTIONAL INDUSTRIES**

Proposals from the private sector will originate in one of two circumstances.

### **2.1 Unsolicited proposals**

On occasions, private sector organisations will make application to Corrective Services Industries with commercial proposals. These proposals will be passed to the Business Development Manager who will initiate evaluation of the proposal in compliance with probity requirements and government policies and procedures.

In the case of proposals involving Level 1 & 2 private sector levels a formal expression of interest process is required. The Director CSI may determine in certain cases that an expression of interest process is required for other levels (i.e. level 3, 4 & 5).

### **2.2 Expressions of Interest (EOI)**

Most private sector correctional industry programs will result from a formal EOI process conducted by Corrective Services Industries.

An EOI (otherwise referred to as market testing) will be recommended by the Business Development Manager in cases where there is identified and continuing correctional industry capacity and dedication of resources.

EOI's will be issued and evaluated in compliance with the "NSW Government Procurement. Code of Practice" 1999 and the "NSW Government Procurement. Code of Tendering" 1999.

All EOI's will contain a condition requiring the successful respondent to enter into an appropriate contract with Corrective Services Industries. The term of such contracts may vary depending on commercial circumstances, but will normally be for two years with a two year option.

The EOI will be subject to a publication strategy that seeks to maximise exposure within the relevant industry and/or region. In this way CSI ensures it maximises the potential opportunities identified and reduces possible criticism that adequate access has not been provided for the private sector to become involved in correctional industry program. This also includes provision of an information portfolio covering the scope of the expression of interest, advertising copy and proponent information and evaluation elements.

### **3. PROPOSAL EVALUATION ELEMENTS**

In evaluating proposals from the private sector, the following elements are to be considered:

- (i) Many proposals are marginal operations, which seek to utilise the Department's access to Government funds. In effect many proposals are disguised requests for subsidised funding or subsidised facilities.

Corrective Service Industries will not pass over to the private sector, publicly owned assets at less than commercial terms. This implies that if Corrective Services Industries funds aspects of an operation then a commercial rate of interest will be charged. Similarly if the private sector wishes to occupy Corrective Services Industries facilities, then a rental will be charged (this is implied in the cost rate).
- (ii) Corrective Services Industries will avoid marginal costing, in which the cost of additional workload is only costed as the incremental cost of labour and material. Marginal costing results in a reduced cost which is then passed on to the customer as a reduced price. If workload assumptions are not met, then the reduced price is often less than real cost. The closest that Corrective Service Industries will come to marginal costing is the use of an individual project evaluation model which, for a new incremental business, may include, for example, limited recovery for the cost of the Corrective Services corporate office (which would have been assumed to have been absorbed over existing business units).
- (iii) Corrective Services Industries is not exploiting "cheap labour". Some private sector proposals however assume that they can recreate third world labour conditions and wage rates within a correctional environment. Private sector correctional industry will only be accepted if Corrective Services Industries both recovers its full cost (including if necessary, an interest component) and if the project meets government policy objectives, which includes inmate training and development.

This reference is particularly relevant for proposals, which offer the benefit of import replacement only, at potentially less than adequate return for Corrective Services Industries. A clear objective of Correctional Industry operation is not the abolition of imports per se, at any price.

## **4. EVALUATION OF PRIVATE SECTOR PROPOSALS**

### **4.1 General evaluation criteria**

The general criteria against which a private sector proposal (whether in response to an advertised EOI or an unsolicited proposal) will be evaluated are listed below. It should be noted that this list is not exhaustive and an EOI may be evaluated, if applicable, against additional criteria and specifications.

- full details of the proponent, the nature of the proponent's current business and references to support the proponent's credentials;
- the nature of the business proposed;
- the proponent's objectives and business related aspects that underlie the proposed venture;
- list of the proponent's requirements and expectations in relation to the supervision of inmates, number of inmates and inmate skill levels;
- the nature of the location/s for the proposed venture;
- the feasibility of the proposed venture to a Correctional Centre environment utilising inmate labour;
- the extent to which the productive capacity of the offered business unit is to be utilised by the proposed venture including recognition of the operating conditions and operating hours of the facility;
- the continuity with which the productive capacity of the offered business unit can be sustained in both the short and long term;
- the proposed level of involvement in the venture with particular emphasis upon management and staffing of the facility and interface with Department staff;
- the evaluation of the proposed economic arrangements (note that evaluation of economic benefits is provided in section 5 of this policy);
- the extent to which the proponent will supply plant and equipment, materials, consumables and transport;
- the commencement date and proposed term of the venture. Note that CSI has a preference for a 2 year term with an option thereafter for a further 2 years;

- the impact of the proposed venture on other Australian businesses including the likely reaction of Australian businesses. Note that a proponent is to provide an industry impact statement, which will require the endorsement of the Correctional Industries Consultative Council.
- the nature of any contract which the proponent will enter into. Note that all private sector Correctional Industry proposals must be documented by a contract which will be subject to review by the Corporate Counsel, prior to execution;
- the extent to which CSI is required to accept any risk of the venture;

#### **4.2 Evaluation panel**

The evaluation of private sector proposals will be the responsibility of an evaluation panel. The panel at a minimum, will consist of:

- the CSI Business Development Manager;
- the CSI Operations Development Manager;
- the CSI Commercial Manager or his delegate; and
- a representative nominated by the SACICS

The evaluation panel will meet, prior to the opening of EOI responses and prepare the evaluation methodology which is not to be changed during the course of the evaluation.

A formal evaluation report is to be submitted to the Director Corrective Services Industries, recommending either:

- the EOI response which best meets the evaluation criteria; or
- if all of the responses are considered unsatisfactory, then the panel should recommend that none of the respondents be selected as the preferred supplier.

#### **4.3 Advice to EOI respondents**

Prior to the advertisement of an EOI, CSI will select a suitably qualified and experienced officer to receive and answer questions from potential respondents.

The CSI contact officer will formally record all questions from, and answers to, potential respondents and provide all other potential respondents (for example the list of EOI inquirers) with a copy of these questions and answers.

## **5. DETERMINATION OF ECONOMIC BENEFIT OF PROPOSALS**

In general there are two different methods of identifying the economic benefit to CSI and government, of private sector proposals:

- cost benefit analysis; and
- discounted cash flow (DCF) analysis.

[Figure 6.5.1](#) shows the financial evaluation steps involved in each of these evaluation paths.

### **5.1 Data collection**

Before evaluation of private sector proposals can be undertaken, the following minimum data is required.

- (i) Is Corrective Services Industries producing a product. Identify:
  - whether CSI provides materials from CSI funds; and
  - who pays for 'on costs' such as transport.
- (ii) How much material and labour goes into each product (note that labour will be measured in hours or minutes). The customer should be requested to provide copies of planning sheets and standard times (which provides comparison with Corrective Services Industries productivity).
- (iii) Will the private sector manage the business unit or does Corrective Services Industries need to provide the supervision. Does the business unit require Corrective Services Industries staff.
- (iv) Does Corrective Services Industries have to invest in the project. That is does Corrective Services Industries provide capital equipment or inventories.
- (v) How much will the customer be prepared to pay for the product and service. Wherever possible, Corrective Services Industries staff should avoid indicating to the customer the Corrective Services Industries projected cost. Corrective Services Industries should elicit a price from the customer.

### **5.2 Start up costs**

Generally there will be limited start up costs associated with private sector correctional industry programs. These are frequently in the nature of initial low productivity during the training phase.

If Corrective Services Industries is funding the cost (for example Corrective services Industries revenue is likely to be related to productive output), then the start up time is to be estimated and the associated lost production and revenue quantified. If the revenue loss is in the order of 5% of the annual revenue,

then it can be ignored. If the revenue loss is greater than 5% then the additional labour cost is to be taken up in the first year of operation, as start up costs.

Similarly any recurrent expenditure (but not capital) which is incurred is to be taken up in year one and offset against the first year's revenue.

Experience has shown that most private sector correctional industry programs has minimal start up costs and that expected commercial performance in the first year is similar to that in all other years. If the performance in subsequent periods is radically different to the first year performance, it is more likely to be the result of the customer changing the mode of operations rather than due to the effects of a leaning curve. [Before a customer changes the mode of operations, Corrective services Industries must be consulted and the resultant proposal is treated as a new evaluation].

It is to be noted that full private sector involvement requires the private sector contractor to perform all training and hence Corrective Services Industries will not be responsible for inmate training and productivity. The Department is however required to provide an effective institutional management interface including proper screening of inmates.

### **5.3 Cost benefit analysis - Simple case**

The simplest project evaluation analysis is a cost benefit analysis to cost out the product and identify if the cost of the product is less than the anticipated sell price.

In calculating the cost, the standard time for the product is to be extended out using the average direct cost rate. The current hourly labour/overhead charge out rate is to be utilised.

This cost rate includes the hourly labour rate paid to inmates, the cost of institutional staff associated with program operation (currently 50% of an Officer's time), the cost of institutional overheads (such as electricity), an allowance for depreciation, an allowance for Corporate overheads and an allowance for the cost of capital committed by the Department. Corrective Services Industries' staff are referred to [section 5.15 Costing Policy](#).

To this labour and overhead cost must be added the cost of any materials provided by Corrective Services Industries. An appropriate bill of material is to be developed. An allowance for scrap and a quantification of consumables (for example hardware items, welding items etc) is also to be included.

If the cost per product is less than the customer's price and returns an appropriate margin, then the proposal is likely to fulfil economic evaluation criteria.

#### **Individual model**

If the simple cost benefit analysis on the individual product does not show an acceptable commercial return, an individual computer model can be employed. In this method, which is more accurate, all costs are listed and quantified rather than assumed to be at the hourly charge out rate.

Generally an individual model will result in a higher commercial return as the (average) charge out rate quoted above, is based on average, whilst an individual model more accurately assesses all costs. For example private sector correctional industry frequently requires less officers (who constitute the largest component of cost).

An individual model is also required where the proposed operation has several production stages, one of which constitutes a limiting operation (that is a "bottle neck"). In this case an individual model accurately determines the total cost of the supporting operations (for example one or more inmates only partially engaged on that activity).

However if an individual model is utilised, then careful consideration must be given to the identification of all costs involved, such as electricity, repairs and maintenance and depreciation (normally taken as 10% pa of the capital investment).

- (i) If the building is purpose built for the customer (whether funded by Corrective Services Industries or not) then an implied rental is to be one of the costs.
- (ii) If the proposal involves the utilisation of existing facilities, then a cost needs to be included to recover the cost of Corrective Services Industries corporate overheads.

This recovery (see section 7 on "Marginal Costing") represents the cost of maintaining the corporate infrastructure, spread over the existing workload. Since existing business units are part of that base workload, proposals utilising existing facilities must continue to carry their share of the existing overhead burden.

- (iii) If the proposal requires the utilisation of new business units then generally no corporate overhead recovery rate is charged.

However, an abbreviated corporate office overhead employed to evaluate private sector correctional industries proposals and to provide ongoing supervision, must be factored into the economic evaluation.

If the proposal reflects a positive return, then the next step is to evaluate the investment payback (section 5).

#### **5.4 Discounted cash flow**

A discounted cash flow (DCF) is a specialised technique to be utilised where either the project has significant investment from Corrective Services Industries or where the cash flows of the project (such as revenue and cost) are irregular.

Basically the project is modelled on a spreadsheet for a period of years (by month) and the individual revenues and costs are determined for each month.

The sum of the net monthly surpluses is then "discounted" back to eliminate the effect of the cost of funds (including inflation) to arrive at a Net Present Value (NPV) which represents the project profit in constant (ie today's) dollars.

Projects which are assessed by DCF analysis are assessed on two results:

- firstly the NPV for the analysis must be positive (that is the discounted net surpluses should exceed the capital and investment costs; and
- the project returns a suitable payback period.

Corrective Services Industries staff conducting a DCF analysis should bear in mind the following DCF practices:

- in NPV analysis, funding costs (that is interest) are not considered because the funding cost is part of the "discount rate" used in the analysis. Corrective Services Industries staff conducting a DCF analysis, should consult the Commercial Manager for the selection of an appropriate discount rate; and
- capital investment, which is usually invested in advance of the project, should be inserted into the analysis at either month 1 or month zero, in the Corrective Services Industries spreadsheet model. A copy of this model is available from the Commercial Manager.

## **5.5 Investment payback**

Regardless of the method utilised to determine an acceptable economic return (that is surplus of price over cost), the project is to be evaluated to determine if that return is sufficient to recover the Corrective Services Industries' capital investment. Capital investment does not include investment in working capital such as inventories etc, as generally private sector correctional industry does not include additional inventory investment.

**Corrective Services Industries requires that all capital investment be recovered from returns generated by that investment within three years of purchase.** This time period is the generally accepted recovery period in the private sector. An investment which takes longer than three years to recover will suffer from the effects of technology change (which might render the investment obsolescent) and the effects of inflation (which reduces the real annual profit required to "repay" the investment).

It is to be noted that the definition of capital includes capital which is funded by Corrective Services Industries together with that funded from the Department's Capital Works funds.

A payback is simply the capital investment divided by the anticipated annual return arising from the project. A resultant number of less than three is acceptable. In the case of an NPV, an average NPV (per annum) is determined and the project payback is simply the capital investment divided by the average (pa) NPV.

## **6. AUTHORISATION**

All proposals for private sector correctional industry programs must be approved by the Director, Corrective Services Industries and endorsed by the Correctional Industries Consultative Council (CICC).

All submissions for approval of private sector correctional industries must be accompanied by:

- a satisfactory economic analysis as outlined above;
- a comprehensive discussion of any non financial advantages which will accrue to inmates.

Typically such benefits would include:

- the prospect of increased or continuous sales to CSI;
  - the possibility of increased inmate employment; or
  - exposure of inmates to appropriate educational and post release opportunities.
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- an analysis of the impact that the proposed private sector correctional industry will have on private sector markets (refer [section 4.5](#) in connection with the provision of an industry impact statement.

## **7. OPERATION OF PRIVATE SECTOR CORRECTIONAL INDUSTRY PROGRAMS**

At each location, where a private sector correctional industry program is domiciled, the CSI Operations Manager / Manager of Industries is to ensure that contract conditions are met and appropriate continuing records maintained over critical contract elements e.g. number of inmates provided, specific requests of contractor to temporarily vary conditions or where specific provisions have not been met.

In the case of contract conditions not being met the relevant Regional Business Manager is to be briefed and resolution provided to ensure CSI interests are preserved.

The Contracts Manager or designated CSI Manager has responsibility to monitor the performance of private sector contractual obligations. Any breach of contractual obligations is to be communicated to the CSI Business Development Manager.

This responsibility is to ensure that contractual obligations of CSI and the contractor are fulfilled and that, in particular, CSI is protected from potential litigation as a result of breach of contract conditions.

The CSI Business Development Manager is responsible for the overall management currency of private sector correctional industry contract arrangements.

Where the contractual breach is financial in nature, the Contracts Manager is to advise the Commercial Manager.

In cases where there is a conflict between the commercial and contractual arrangements and the Department's Policies and Guidelines, then the latter will have prominence. In these cases the CSI Business Development Manager will negotiate an appropriate outcome with the private sector entity.

## **8. TERMINATION OF CONTRACTS**

All private sector correctional industry programs will be documented by an appropriate contract between Corrective Services Industries and the private sector entity. This contract will contain, amongst other sections, details of the conditions under which a contract may be terminated.

After termination or expiry of a contract, commercial arrangements may continue with the private sector entity for a commercial period whilst replacement contracts are renegotiated.

After contract termination, the availability of the private sector facility must be re advertised by an EOI process.

## **9. DISPUTE RESOLUTION**

Any contract between Corrective Services Industries and a private sector entity must contain acceptable mechanisms for dispute resolution.

## **10. PRIVATE SECTOR CORRECTIONAL INDUSTRY FLOWCHART**

(See Figure 6.5.1)

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