Contract Management Issues

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Agenda

1. Managing Operational Contracts – Key Activities
2. Benchmarking and Market Testing
3. Refinancing
4. Summary
Organisational Issues - Service Delivery

- HR Handling
- Project Management
- Change Management
- Organisational Structure & Governance
- Stakeholder Management
- Communications
- Record Keeping
- Policies and Procedures
Financial Issues - Service Delivery

- Auditing
- Value for Money
- Affordability
- Change Control
- Open book Accounting
- Payment Mechanism
- Fraud
Operational Issues - Service Delivery

- Service Levels And KPIs
- Performance Measurement and Benefit Tracking
- On-going Integrity Checks
- Continuous Improvement
- Value Testing/Benchmarking
- Dispute Avoidance and Resolution
Why is Contract Management important?

“There is strong evidence to suggest that the existence of a dedicated team and frequent meetings between the two sides to review performance levels helps improve service levels”


“A great contract at signing can be the worst six months later, unless someone is carefully managing its operation”

Head of Procurement, University College London
What are the Relevant Skills?

• Project management, commercial expertise and negotiation.
• User training - simplified contract guides and user manuals.
• Advantageous if a contract manager has been involved in the procurement phase of a project.
• If not, formal handover procedures are important.

Know the contract!
When does Contract Management happen?

At all stages of the contract management lifecycle:

“The foundations for contract management are laid in the stages before contract award, including the procurement process”
Resource Planning

• OGC says 2% of contract value for contract management
• NAO says at least 1 full time person for every contract
• But it’s ‘horses for courses’ – no set formula
• More required during mobilisation and up to 18 months into operation
• Ongoing support from procurement team
• Continuity of staff from procurement to operations
• Budgeting for external advice
• Planning for ‘peaks’ e.g. benchmarking
Preparing for Operations – Checklist

- Review contract requirements re contract monitoring
- Decide size and structure of team
- Assess available internal resources or if recruitment needed
- Clarify roles and responsibilities
- Assess and agree involvement of users/stakeholders in contract monitoring
- Assess training needs and develop training plan
- Prepare contract management portfolio
- Prepare budgets
Transition Plan

- Details of Authority resources – who and when
- Helpdesk establishment
- Contact details
- Staff consultation
- Finalisation of Contract documents
- Contract Management Team induction training
- User familiarisation workshops
- Start up meetings
- Future milestones (‘Contract Diary’)
- Trial running
Contractor should have in place:

- **Performance** monitoring procedures
- **Quality management** and management information systems
- Procedures for the **management of its sub-contractors**
- **Systems for recording** contract information
- A **reporting** mechanism
- A robust **audit trail** supporting its **assessment of performance**
- The **Authority** should ensure that the **Contractor’s process** ties in to the local authority meeting and payment processes.
Managing Contracts: Key Activities

• User satisfaction surveys
• Complaint logs/help desk
• Physical inspections
• Spot checks and testing
• Sign off/certification
• Adherence to monitoring plans
• Agreeing and reflecting change control/variations
• Reporting and review of reports
Why is the Payment Mechanism Important?

The Payment Mechanism:

• Is Central to the Contract - Core Schedule
• Reflects the financial effect of the allocation of risk
• Determines the payments that the Authority will make to the Contractor
• Sets out indexation arrangements
• Addresses Contractor incentives to deliver the Services
• Sets out the Service Credit or Deduction regime
Benchmarking and market testing – Definitions (HM Treasury)

- **Benchmarking** is the process by which the Contractor compares either its own costs or the costs of its subcontractors providing soft services against the market cost of such services. (Can lead to price adjustment but not a change in subcontractor).

- **Market Testing** means the re-tendering by the Contractor of the relevant soft service to test whether that service still represents value for money. (Can give rise to replacement of subcontractor).
Benchmarking and Market Testing - Objective

• A key requirement of all Contracts is to obtain Value for Money for Public Sector Authorities throughout the life of the Contract, and not to erode Value for Money already obtained during the procurement process.

• Value for Money can be achieved through benchmarking, market testing, savings and efficiencies, service improvements, refinancing and profit sharing.

Benchmarking and Market Testing are tools to ensure VfM. Collectively they are referred to as **Value Testing**.
What benchmarking is for

Benchmarking is intended to protect both parties to a PFI contract:

• It is meant to protect the Contractor from unforeseeable cost pressures over the life of the contract due to:
  – particular sector-related influences on costs;
  – geographical influences on costs; or
  – operational cost consequences of changes in law.

which may lead to cost increases significantly above the rate of any inflation indexation in the Contract.

• The Authority is protected by ensuring that continued value for money is achieved from the PFI contract by comparing it with prices in the current marketplace.

Benchmarking - not to protect Contractors from general inflationary cost increases or to recompense an inefficient service provider.
Benchmarking / market testing - Key principles (1)

- Contractor’s responsibility
- Normally, only soft services appropriate (consider if grouping appropriate)
- Plan and agree procedures for carrying out exercise and implementing any changes
- Contract should specify scope, timing, frequency, consequences
- Do not underestimate time required
Benchmarking / market testing - Key principles (2)

- Benchmarking
  - robust comparable benchmarks

- Market Testing
  - existence of competitive market
  - fairness and transparency

- Robust validation and interpretation of results

- Document lessons learned
Refinancing

Any change in the terms of third party debt financing:

Most commonly it is the repayment of senior debt by the raising of new debt (when long term viability is proven – lower risk);
  – on more advantageous terms;
  – repaid over a longer term;
  – larger amount of debt.

Analogous to changing mortgage on your home.
Pre Refinancing Cash Flows
Post Refinancing Cash Flows
Calculating the Refinancing Gain

• Pre-refinancing shareholder payments are calculated:
  – based on actual performance;
  – updated forecasts (costs, inflation, interest rates);
  – assuming no refinancing.

• Post-refinancing shareholder payments:
  – using same assumptions as above.
  – discount rate is the original target shareholder return (Base Case or Threshold Equity IRR)
Key terms

- Public Sector consent
- 50% up to £1m, 60% further gains up to £3m and 70% thereafter of refinancing gain (where base case equity IRR exceeded) to Public Sector.
- Public authority can request a refinancing
- Calculation of gain based on projected increases in shareholder return discounted at base case equity IRR.
- Care about Public Sector exposure to termination liabilities.
What have we learned?

• The big issues have been consistent:
  – Resources and Governance
  – Benchmarking / Market Testing
  – Managing Variations
  – Data and information are essential

LESSONS FROM OPERATIONAL EXPERIENCE
MUST BE USED TO IMPROVE THE PROCUREMENT PROCESS
Surveys: Main Findings

- High Standards of Performance
- High Levels of Contract Manager Satisfaction
- Good Relationships
- High Levels of User Satisfaction
- Problems Resolved in Time
- Payment Deductions Generally Effective
- Dispute Resolution Rarely Used
Operational issues once a partnership is up and running

Most important issue:

**GETTING** A PARTNERSHIP UP AND RUNNING

The transition period (from procurement to operation) is **vital**