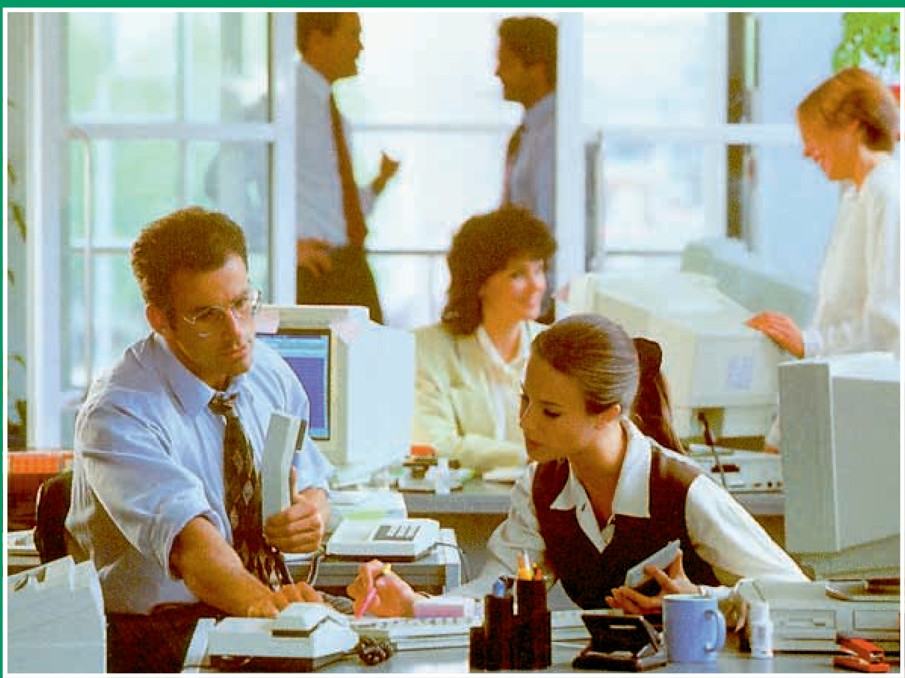
Report by the
Comptroller and Auditor General

Contributions Agency

The Contract to Develop and Operate the Replacement National Insurance Recording System



HC 12 Session 1997-98
29 May 1997

This report has been prepared under Section 6 of the National Audit Act 1983 for presentation to the House of Commons in accordance with Section 9 of the Act.

John Bourn
Comptroller and Auditor General

National Audit Office
25 March 1997

The Comptroller and Auditor General is the head of the National Audit Office employing some 750 staff. He, and the National Audit Office, are totally independent of Government. He certifies the accounts of all Government departments and a wide range of other public sector bodies; and he has statutory authority to report to Parliament on the economy, efficiency and effectiveness with which departments and other bodies have used their resources.

Contents

Executive summary

1 The National Insurance Recording system supports the Contributions Agency, an Executive Agency of the Department of Social Security. Computers have been used to support the collection and recording of National Insurance contributions since the 1960s. The system is extremely large, maintaining details on some 64 million National Insurance accounts of which around 29 million require updating each year. Approximately one million new National Insurance accounts are created each year.

2 In May 1995, the Agency signed a contract with Andersen Consulting to develop a replacement for the existing National Insurance Recording system (NIRS1) by February 1997 and operate it for seven years from that date. Under the contract, the replacement system, known as NIRS2, would also be enhanced over the period February 1997 to April 1999 to provide additional services to the Agency. The successful development of the new system is critical to provide the necessary support for new pensions provisions which came into effect in April 1997.

3 The contract was the first major Information Technology contract awarded under the Private Finance Initiative. Andersen Consulting are to receive no payment until the system is operating satisfactorily, from which time they are to be paid on the basis of usage. The cost of the system to the Agency is likely to be about £134 million over the life of the contract (at April 1995 prices).

4 In July 1996, following an unsolicited approach from Andersen Consulting to vary the implementation timetable in a way which, in their view, would result in less risk for both themselves and the Agency, the original contract was amended. The replacement of NIRS1 will now be phased between February 1997 and April 1998 and Andersen Consulting will now only be entitled to payments from the later date, assuming satisfactory delivery of the specified service. Support for the new pensions provisions between April 1997 and April 1998 will be provided by a combination of the existing NIRS1 system and that part of the replacement system to be introduced in October 1997. The final date for the completion of the development phase of the contract remains April 1999.

5 The National Audit Office examined whether the NIRS2 contract is likely to represent a good deal for the taxpayer and in particular:

- Whether the procurement process was managed efficiently, thoroughly and fairly;

- Whether the contract is likely to provide good value for money; and

- The effectiveness of the arrangements to ensure compliance with the contract including the impact of the revised timetable.

Management of the procurement process

6 **The procurement was well-managed**. The contract was signed within only nine months of the announcement of the competition in the Official Journal of the European Communities in August 1994. Amongst other things, **this fast process helped to minimise bidders' costs**. The Agency attracted 34 international information technology companies to the competition. Eight organisations succeeded in pre-qualifying for the competition. **The short-listing process was well managed to produce three credible bidders each of whom made acceptable proposals.**

7 **These proposals were evaluated against pre-determined criteria by an evaluation panel which included appropriate external advisers appointed by competition. Ministers were advised of the possibility of delay to the project with consequences for the implementation of the proposed pension reforms but the Agency considered they had sufficient contingency margin to manage the risk.**

8 The winning bid was chosen in line with the criterion set out in the original advertisement which was that the "economically most advantageous" bid - that the bid provided the best value for money - would be chosen. **All three bids complied with the Agency's core requirements and the financial evaluation of the final offers showed that the price of Andersen Consulting's offer was significantly cheaper than those of the other two bidders under all likely scenarios**. The contract includes incentives for Andersen Consulting to ensure that the technology used remains up to date until the contract is re-competed for after seven years.

9 In evaluating competing proposals the Agency were concerned to ensure that they maintained the scope for considering innovative ideas put forward by bidders, **although bidders felt that the Agency did not appear to take account of any additional benefits offered by their individual proposals. The Agency reject this view believing that they missed nothing that would have provided**

better value for money. They considered all additional ideas, and accepted those key ones (for example transfer of NIRS1) that they considered beneficial, and which were consistent with the original advertisement announcing the competition.

Value for money

10 **Provided Andersen Consulting are able to deliver the service contracted for, the contract represents strikingly good value for money which is largely unaffected by the delay to delivery envisaged by the amended contract.**

11 **The contract provides for all the Agency's objectives for this project to be achieved. Substantial transfer of risk from the Agency to the private sector has taken place although the non-financial risk of delayed delivery - the impact of delay to the pension reforms - remains with the Agency**. The Contributions Agency is able to control its costs by the use of a ceiling on the number of transactions for which payment will be made. Competitive pressure to win the contract was maintained at a high level to a very late stage in the procurement process and the contract was awarded within one month of best and final offers being received from the three short-listed bidders.

12 **The revised implementation timetable has some impact on the value for money offered by the deal but, subject to delivery of the final system to specification, it remains strikingly good value for money**. Under the revised timetable, the Agency will incur estimated additional costs of £3.8 million, up to £3.1 million of which will be met by Andersen Consulting through compensation. In addition, Andersen Consulting will absorb its extra costs and lost revenues in keeping the price of the deal itself unchanged. These factors can be seen as a positive impact of the Private Finance Initiative. There are also potential estimated lost savings for the Contributions Agency and the Benefits Agency of up to £4 million and £2 million respectively.

Contract management and changes to the delivery timetable

13 The Contributions Agency established a contract management team and user group to monitor the continuing development and testing of the new system and established arrangements for regular progress reporting. **As part of the agreement of the revised timetable additional contractual milestones were added to enable closer monitoring of progress**. Critical service levels were included in the contract, and detailed service levels and methods of performance reporting were left to be agreed at a later stage. These were satisfactorily resolved for the first release stage in February 1997.

14 **The Contributions Agency have developed contingency plans to cover the delay to the replacement of NIRS1**. These will allow them to support the new pensions legislation between April 1997 and April 1998 using the existing NIRS1 system and that part of its replacement completed by Andersen Consulting. Beyond that date the scope for further contingency is very limited.

15 **The contract provides for financial remedies in the event of failure by Andersen Consulting to deliver by the due dates and for any additional costs to be met by them**. There are also provisions for financial remedies for poor performance during the operational phase of the contract. In the event of financial failure of Andersen Consulting, the Agency are covered by guarantees provided by the Arthur Andersen Worldwide Organisation. They are also entitled to receive a complete set of back-up software and other data and documentation necessary to enable them to continue to provide the service.

Recommendations

16 We recommend the following examples of good practice and some lessons from this major project which may be of value in pursuing other Private Finance Initiative schemes:

1. Maintain competitive pressure throughout the bidding process while remaining sensitive to bidders' costs.

The maintenance of competitive pressure is critical to achieving the best value for money. Proceeding with too few bidders can weaken such pressure, but so can proceeding with too many, hence a balance needs to be struck.

2. Test the enthusiasm of the market for such schemes through consultation with appropriate organisations before the competition is formally announced.

Such action will help to determine whether there is likely to be sufficient interest to mount a worthwhile competition and help the procuring body draw up a specification which can be clearly understood by potential bidders.

3. The advertisement announcing the competition in the Official Journal of the European Communities should be worded to allow flexibility in contract negotiations.

Too specific a statement of requirements may deter some potential bidders and may restrict the opportunity to consider worthwhile innovative suggestions put forward by bidders during the competition.

4. Fully consider the impact of any delay to the organisation's key business activities and ensure adequate contingency arrangements are in place.

It is unlikely that the non-financial impact of delay can be transferred to the contractor. Contingency arrangements should be in place which fully recognise the potential impact of delay.

5. Set out clearly the criteria against which consortia seeking to pre-qualify will be assessed, the bids will be evaluated and the core requirements bidders must satisfy.

Bidders need to be properly informed if they are to submit proposals which meet business needs. In setting out the criteria, however, care should be taken to avoid introducing unnecessary constraints which might stifle worthwhile innovation.

6. When assessing the value for money offered by bids, any public sector comparators should be based on the best available information but the degree of precision required in any case should be considered before committing resources to the calculation of a comparator.

Public sector comparators are sensitive to a number of variables such as the discount rate used and assumptions about volume of activities that give rise to charges. Where, for example, private sector provision clearly offers much better value for money there may be no need for a precise calculation.

Part 1: Management of the procurement process

1.1 This part of the report examines the speed, thoroughness and fairness with which the Contributions Agency managed the procurement competition.

The Private Finance Initiative

NIRS2 became a Private Finance Initiative Project in July 1994 and a contract was signed in May 1995

1.2 The Private Finance Initiative was announced by the Chancellor of the Exchequer in his 1992 Autumn Statement. He said that it had the objective of finding new ways of mobilising the private sector to meet needs which have traditionally been met only by the public sector. It is intended to improve the value for money of public sector projects by encouraging the development of closer relationships between the public and private sectors through the transfer of risk and responsibility, and to enable the public sector to benefit from appropriate private sector skills and innovation in the delivery and procurement of services.

1.3 The essence of a Private Finance Initiative deal as compared with traditional procurement is that the Government contracts with the private sector for the provision of a service over time rather than for the provision of a capital asset.

1.4 The government's policy is that Private Finance Initiative projects should be undertaken when they provide better value for money than conventional procurement routes. The Treasury require departments to consider using the Private Finance Initiative route for all capital projects. Departments undertaking Private Finance Initiative projects are therefore expected:

a) to carry out the procurement by a competitive process which complies with all relevant public procurement law;

b) to be able to show that the resulting deal can be expected to provide value for money; and

c) to put in place arrangements which ensure that the project will meet their service requirements with appropriate flexibility over the contract period.

The National Insurance Recording system was in need of replacement

1.5 In 1992, work began on developing a replacement for NIRS1. The existing system was very old, dating in parts back to the 1970s, and becoming increasingly difficult to maintain. The Agency feared that, if action was not taken, the situation could deteriorate rapidly to the point where the system could no longer effectively support its day to day operations and where even relatively minor legislative changes could not be implemented.

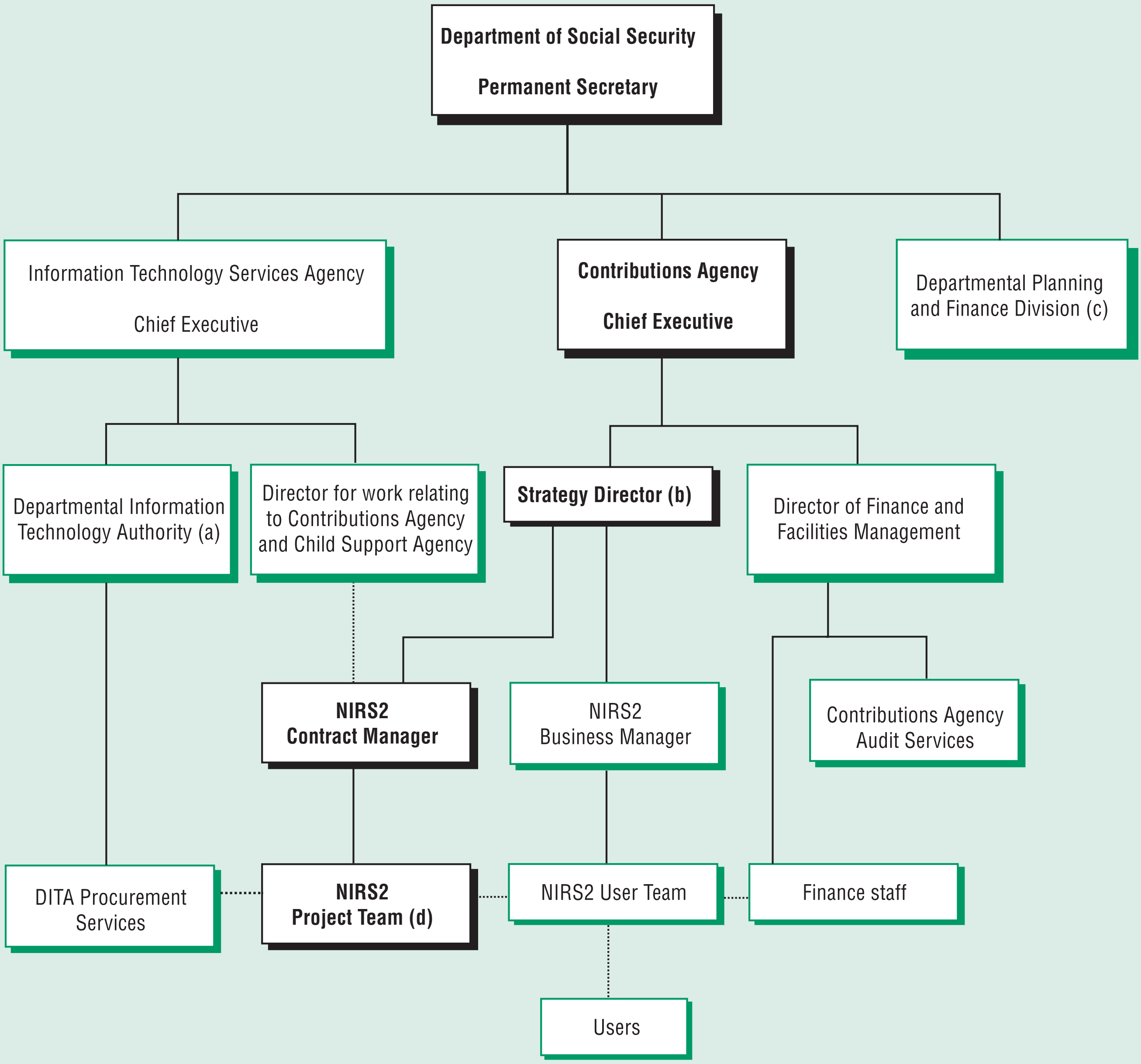
1.6 The original business case for the traditional procurement for NIRS2 envisaged the system being technically complete in November 1996 to ensure that it would be fully operative before the implementation of new pensions legislation in April 1997. NIRS2 was considered essential by the Department and the Agency if the more complex pension arrangements to be introduced by the new legislation were to be properly supported. The Agency recognised that by following the Private Finance Initiative route, implementation could be delayed until April 1997 and that any further delay could put the introduction of the new pension arrangements at risk. A competition was announced in August 1994 in the Official Journal of the European Communities. All bidders submitted proposals which met the required implementation date of April 1997. The contract was awarded to Andersen Consulting in April 1995 and signed in May 1995.

The Agency established appropriate arrangements and objectives for managing the competition

1.7 The competition for the contract was managed by a project team headed by a project manager from the Information Technology Services Agency - the information technology arm of the Department - and included representatives from the Contributions Agency and external legal and financial advisers. The work of the project team was overseen by a project board, chaired by the Director of Information Services and Business Planning of the Contributions Agency, which included representatives from the Department, HM Treasury, the Private Finance Panel Executive and also the head of the project team. Figure 1 illustrates the relationship between the various parties involved. Appendix 1 provides some background to National Insurance contributions and to the key organisations involved in the NIRS2 contract.

1.8 The objectives set for the NIRS2 Project were to achieve the following through the medium of private finance:

Figure 1: Organisation chart showing relationships between parts of the Department and its Agencies and the key reporting line for the NIRS2 Project



Notes: (a) Provide a strategy for the Department's information technology, and manage and regulate the competitive supply of information technology.
(b) Chairman of the NIRS2 Project and Programme Management Boards.
(c) Responsibilities include the scrutiny of Contributions Agency's estimates and their financial plans.
(d) Became the Programme Management Team once the contract was signed, and later the Contributions Agency Information Technology Contracts Team with an expanded role.

a) full replacement of the existing NIRS1 computer system;

b) development and implementation of new computer procedures to support legislative changes arising from the Government's Pension Reform Act due to take effect from April 1997;

c) conversion of all data required to be carried forward from the existing NIRS1 to the replacement NIRS2 system;

d) enabling users of the new NIRS2 system to move from existing paper based working practices to efficient procedures using modern workflow management techniques;

e) securing effective and resilient backup arrangements from the supplier in the event of serious and lasting disruption to the NIRS2 service.

Implicit within these objectives and in common with any Private Finance Initiative contract was the need for any contract entered into to demonstrate value for money.

The procurement was carried out to a tight timetable and to budget

1.9 The letting of public services contracts is governed by European Union regulations laid down in the Public Services Contracts R egulations 1993 (SI 1993 No. 3228). The regulations require that all such contracts valued above certain thresholds should be advertised in the Official Journal of the European Communities and lay down detailed regulations on the procedures to be used when letting such contracts. The Contributions Agency accordingly published an advertisement in the Official Journal in August 1994 asking for expressions of interest in the NIRS2 contract by September 1994. With the assistance of the Department's information technology procurement specialists, the Contributions Agency and the Information Technology Services Agency developed a plan for the conduct of the competition. Figure 2 outlines the timetable set for the procurement and the actual dates achieved.

1.10 The Contributions Agency advised Ministers that conducting a competition under the Private Finance Initiative would delay the implementation of NIRS2 by about six months and that an implementation date of April 1997 - required to support the pension reforms - was still ambitious. Ministers were also reminded that major information technology projects had a history of being delivered later than planned. The Agency believed that the risk of

Figure 2: The NIRS2 procurement timetable

Target Date	Event	Date Achieved
13 August 1994	Advertisement for the NIRS2 competition published in the Official Journal of the European Communities	13 August 1994
5 September 1994	Deadline for responses to the advertisement and issue of questionnaires to suppliers who had expressed an interest	5 September 1994
16 September 1994	Deadline for the return of the questionnaires	16 September 1994
28 September 1994	Issue of Statement of Service Requirement and contract structure documentation to short-listed suppliers	12 October 1994
7 December 1994	Deadline for the receipt of indicative proposals from short-listed suppliers	29 December 1994
22 March 1995	Issue of Invitation to Tender to suppliers with acceptable indicative proposals	31 March 1995
4 April 1995	Award of contract	27 April 1995
-	Contract signed	24 May 1995

Source: The Contributions Agency

The procurement process took nine months to complete.

delay to the pensions reforms was manageable as they had contingency arrangements in place which could cover for any delay up to December 1997.

1.11 The final decision to adopt the Private Finance Initiative route was taken by Ministers in June 1994 after discussions with potential providers had indicated that implementation was possible in time to support the pension reforms providing two years were available to develop the system. To achieve this, the competition would need to be completed and a contract awarded by April 1995 at the latest.

1.12 The Contributions Agency succeeded in their aim and were able to award the contract in April 1995, just under nine months after the original advertisement was published. The three short-listed suppliers told us they thought the timetable was reasonable. Two of the suppliers said that keeping to a tight timetable was the best way for the Contributions Agency to minimise bidders' costs, because the longer the process took the higher their costs would have been. The other supplier thought that they were under greater pressure as their previous knowledge of the Contributions Agency's business activities was more limited than that of the other two. The suppliers told us that their bidding costs were in the range £0.5 million to £2.5 million each.

1.13 The Contributions Agency recognised the need to control their own internal administrative costs for the project. In July 1994 they made their first estimate of the internal costs of the procurement exercise to be £473,000. However, this included no external advisers' costs and an expectation that the contract would be awarded in February 1995. By October 1994 they realised there would be significant charges for solicitors and financial advisers and that they would not reach award of the contract until April 1995. So the final budget for the internal costs approved by the Project Board in October 1994 was £1.2 million (£323,000 for private sector advisers) for the financial year 1994-95. The Project Board then monitored expenditure against budget by means of monthly expenditure reports. Actual expenditure in that financial year was £1.23 million including £325,000 on external advisers.

Appropriate external advisers were appointed

The Contributions Agency's management of the competition was thorough

1.14 As well as involving Departmental information technology specialists, the Contributions Agency appointed Dibb, Lupton and Broomhead without a new competition to provide legal advice as a framework was already in place which provided for that firm to provide all of the Department's information technology related legal advice. External financial advice was initially provided by Charterhouse Bank as sub-contractors to Dibb, Lupton and Broomhead. However, in October 1994 the Contributions Agency decided that they should obtain financial advice directly. After a competition Charterhouse Bank were selected. Both pieces of work were paid for on a fixed price basis. The Contributions Agency did not seek the assistance of private sector information technology consultants prior to letting the contract. They have since appointed such an adviser, following a competition, to assist with the assessments required to monitor implementation. The Contributions Agency considered that they had sufficient experience within the Information Technology Services Agency available to them during the procurement process. Finally, the Agency employed PA Consulting to review the robustness of the contract itself prior to award.

Interest was generated from numerous major information technology companies

1.15 Expressions of interest were received from 34 companies by the 5 September 1994 deadline. A questionnaire was issued to each of those companies requesting additional information to demonstrate they had sufficient resources and experience to fulfil the contract . The Contributions Agency considered that by using this process of pre-qualification to short-list bidders the task of evaluating their subsequent bids would be simplified. Eight of the companies returned the questionnaire by the 16 September deadline (Figure 3).

Figure 3: Firms short-listed following prequalification

Amdahl UK Ltd	Electronic Data Systems Ltd/SEMA
International Computers Ltd	Syntegra Ltd
CSC Computer Sciences Ltd	Easams Ltd
Andersen Consulting	IBM UK (Holdings) Ltd

Source: The Contributions Agency

Eight organisations attempted to pre-qualify for short-listing.

Three companies were selected for the short-list

1.16 The Contributions Agency established an evaluation panel to assess the proposals received. The criteria used to evaluate the questionnaire were in accordance with European Union procurement regulations: the capacity of the companies to provide the required services; the companies' past track records; and their experience, financial viability and capability. The short-listed companies were Andersen Consulting, Electronic Data Systems Ltd/SEMA and CSC Computer Sciences Ltd.

1.17 All three were sent a Statement of Service Requirements on 12 October 1994 and were asked to provide their detailed proposals before the end of December 1994. These were not formal bids in response to a formal invitation to tender but proposals to be used as a basis for negotiation before inviting formal bids for the final set of services required. The Statement gave a description of what was required from the new system and the constraints within which the service had to be delivered. It also outlined a suggested payment mechanism although bidders were invited to submit alternative proposals as well as offer additional services to the core requirements. Proposals were received from all three before the due date.

Internal Audit were closely involved in the competition process

1.18 The Department's internal audit were involved in the process from an early stage reviewing the Statement of Service Requirements as it was being drafted and also commenting on the evaluation methodology and the role of the contract management team. An internal audit representative attended all meetings of the evaluation panel as an observer to confirm that the agreed procedures were being followed and that there was an adequate audit trail recording the decisions taken and the reasons for them.

The evaluation criteria were made clear to bidders but not the relative weightings

1.19 Advice to suppliers which was provided with the Statement of Service Requirement, set out the evaluation criteria which would be used to judge the most economically advantageous proposal. The system used to score the proposals was reviewed by the Central Computer and Telecommunications Agency and the Contributions Agency's legal advisers to ensure it was reasonable and fair. The three most important criteria were:

- value for money and price
- fulfilment of requirements as set out in the Statement of Service Requirements
- completion and delivery period

1.20 Weightings were applied in accordance with the degree of importance attached by the Agency to the individual components of the bids, in particular their compliance with the specified service requirements. Although the suppliers were informed about the relative importance of these criteria the weightings used in the evaluation were not made available. The three suppliers told us that it would have been helpful had they been told what the specific weightings attached to each of the evaluation criteria was, as this would have helped them to meet the Agency's requirements better. The Contributions Agency consider that revealing the weightings would not have been beneficial as to disclose them to suppliers might lead to proposals being tailored too closely to meet the criteria thus stifling innovation.

1.21 We consider the Contributions Agency's approach to giving suppliers an indication of the relative importance of the different criteria to have been reasonable. In deciding what information to give bidders about evaluation criteria it is necessary to strike a compromise between, on the one hand, giving too little information so bidders have to guess at what is being looked for, and, on the other hand, giving so much detail that the procuring department in effect dictate the form of the proposal bidders must make. Excessive detail about the relative weightings can also restrict the ability of the department to choose a proposal which is attractive to them for reasons they did not foresee when setting the weightings.

Suppliers were asked to provide a variety of alternative price mechanisms

1.22 In their proposals suppliers were required to provide a unit price for each of 16 (later reduced to 15) types of transaction. The Contributions Agency attached greater importance to some transactions than others and therefore required the suppliers to weight their proposed charges to reflect the relative importance of each transaction type. The Agency provided the suppliers with predictions for the average, maximum and minimum numbers for each type of transaction over the life of the contract When making their proposals, suppliers were asked to give their indicative prices separately for six different combinations arising out of the following: a term of five years, seven years or ten years; fixed prices over the entire period of the contract or variable prices related to the Retail Price Index; and with or without a guaranteed transfer payment at the end of the contract.

1.23 The Contributions Agency also decided that there would be a guaranteed minimum payment to the supplier for each transaction type. They asked the suppliers to set their prices on the basis that they would receive a minimum payment which would be 70 per cent of the amount payable if the Contributions Agency's estimated average volume for each transaction type had occurred. They also invited the suppliers to suggest an alternative percentage level at which the minimum payment would be set and provide their prices accordingly, and they told the suppliers that they expected the price per transaction above the predicted maximum to be much lower than the price for the normal range of volume.

1.24 The Contributions Agency invited suppliers to suggest other possible approaches to pricing the project if they wished. One supplier suggested the payment of a fixed monthly amount which was rejected because it did not involve any risk associated with the actual use of the system being transferred to the supplier contrary to the principle that a Private Finance Initiative deal should be for the supply of services. Another supplier suggested a total cost for the whole contract term which would only be varied if the level of usage was outside a range of 30 per cent either side of the Contributions Agency's predicted averages, in which case the price would be adjusted up or down by a fixed amount for each one per cent movement in volume. The supplier said that actual payments made after 1 April 1995 would be increased in line with the Retail Price Index and by a financing charge. The use of this pricing mechanism was evaluated by the evaluation panel and rejected because it was judged to be more expensive than the Agency's preferred payment method under the likely scenarios identified.

1.25 The reason the Contributions Agency asked the suppliers to provide unit prices on so many different bases was to enable them to judge how suppliers were pricing risks associated with different charging mechanisms. Their analysis of the suppliers' indicative prices led them to the conclusion that a seven year contract period with fixed unit prices offered the best overall solution to their business and financial objectives. This conclusion was arrived at following advice from the Project Financial Manager and Charterhouse Bank who scored the alternative proposals against the business and financial objectives laid down for the procurement. The five year scenario scored badly in business terms as it was felt too short a period to establish the most effective working relationship with suppliers whereas the 10 year scenario scored badly in financial terms as it was considered too long a period without re-competition. The seven year scenario scored best in both business and financial terms. The evaluation also concluded that fixed prices offered a better solution for the Contributions Agency than variable prices subject to the assumption that inflation over the term of the contract was five per cent or more.

A transfer payment mechanism was devised to give the supplier an incentive to keep the system technically up to date

1.26 An important part of the payment mechanism was the non-guaranteed transfer payment which was introduced to test whether the providers would be prepared to share the risk of the system becoming technologically obsolete by the end of the contract period. All three suppliers were required to state in their proposals the level of the transfer payment they would require. The reason for the payment is to give the winning supplier an incentive to ensure that the system remains technically up to date over the period of the contract. If there is another competition for the continuing operation of NIRS2 and it is won by a different supplier who uses the existing system, the transfer payment is recovered by the incumbent supplier from the new supplier as a lump sum. The incumbent supplier will not receive the transfer payment if, when the contract is re-let, a totally new system wins the competition. Should the Contributions Agency decide, at the end of this contract, that they no longer require NIRS2, they will pay the transfer payment to the supplier in a lump sum.

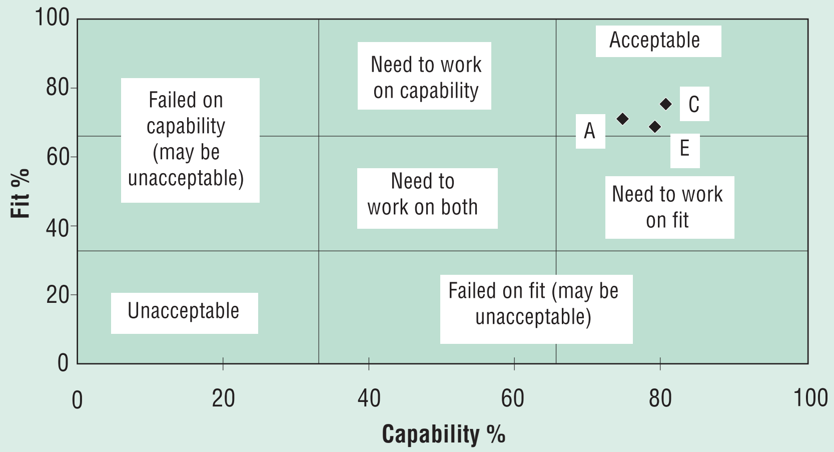
The evaluations of the proposals were carried out by experienced staff and external advisers

1.27 The evaluations of the different proposals were carried out by experienced staff from the Contributions Agency and Information Technology Services Agency assisted by the legal and financial advisers. The main aim of the evaluation was to determine the basis on which tenders would be requested in the formal invitation to tender and to identify the issues to be discussed with the suppliers to enable them to make any necessary adjustments to their proposals before final tendering. The conclusions were reviewed by a separate panel, which included a representative from the Government Centre for Information Systems (CCTA), before being referred to the Project Evaluation Board for ratification.

The Contributions Agency decided to invite all three suppliers to tender for the contract

1.28 The results of the evaluations were summarised into two separate scores for capability and fit. Capability assessed the ability of the companies to deliver their proposal and included such issues as their past record. Fit was concerned with technical, operational, management and service requirements issues. All the suppliers were judged to have met the capability and fit requirements and the final scores awarded were all above the 66 per cent threshold predetermined as being acceptable (Figure 4). In addition Figure 5 shows the net present values - of the expected cost (including the Agency's own input costs) of each of the bidders' proposals over the life of the contract based on a six per cent real discount rate.

Figure 4: Scores achieved by competing proposals at initial evaluation



Bidders	Capability	Fit
Andersen Consulting (A)	75	71
CSC (C)	81	75
EDS/SEMA (E)	79	69

Source: The Contributions Agency

All three proposals achieved scores above the acceptability threshold.

Figure 5: Net Present Values of competing indicative bids at six per cent discount rate

Andersen Consulting (£ million)	CSC (£ million)	EDS/SEMA (£ million)
242	241	263

Source: The Contributions Agency

Note: Based on seven year contract and includes the expected Contributions Agency's input costs

There was little to choose between the Net Present Values of the expected cost of the proposals over the life of the contract.

1.29 The Agency also evaluated the bidders' funding arrangements using their financial advisers Charterhouse Bank. The evaluation concluded that all three methods offered did not add any great complexity or additional risk to the Agency as each supplier proposed to support their bids with the resources available to them and would provide financial guarantees from the highest levels of their respective organisations. The Project Board then agreed that all three bidders should be issued a formal Invitation to Tender and all submitted their best and final offers by 7 April 1995.

The Contributions Agency sought final offers from each supplier based on a common set of services

1.30 In submitting their initial proposals the Agency invited suppliers to make offers of services not directly covered by the Statement of Service Requirements. Following the detailed negotiations which took place with suppliers on their proposals, the Agency refined their requirements. The Agency made it clear to the bidders that they reserved the right to select the most appropriate set of services to fit within their business needs. All three bidders were content to bid on this basis.

1.31 In addition to the provision of NIRS2, the winning supplier was required to enter into a separate contract to operate the existing NIRS1 system from 1 November 1995 until it was completely replaced. Under the NIRS1 contract they would initially be paid £500,000 each month representing a saving of some £412,000 on the Contributions Agency's estimated monthly cost of £912,000 to run NIRS1. When the supplier had ascertained and verified to the Contributions Agency their actual costs of running NIRS1 the monthly payment would be adjusted by an amount equal to the difference between the actual costs and the £912,000 originally estimated. This was aimed at providing immediate savings to the Contributions Agency and in the spirit of risk sharing under the Private Finance Initiative.

1.32 In requesting final offers from the suppliers, the Contributions Agency required suppliers to set a maximum number of transactions, for each transaction type, above which nothing further would be paid. They were also required to quote a daily charging rate for enhancements which would not be included in the basic price, a transfer payment value, and termination charges at certain points in time which would be the maximum amounts the Contributions Agency would have to pay if they terminated the contract at those points.

1.33 Bidders told us that they had concerns that their innovative proposals would be shared with the other bidders to ensure final offers were on the same basis, and were also concerned that proposals not used in the common solution would be made use of by the Contributions Agency, for example in another competition. They also all expressed concern that the Contributions Agency did not appear to take any account of any additional benefits offered by their individual proposals. It appeared to them that when the Contributions Agency were assessing the technical merit of their proposals the requirement was to meet a certain level and then the decision was based solely on price. In their view this was not necessarily the best approach to getting the best value for money. It is, however, clear from Agency papers that, if the comparison of bids in the final offers had resulted in their being little difference between two or three suppliers, further consideration would have been given to their scores in terms of supplier capability and the solution fit, and their relative strengths and weaknesses in important areas. A further consideration for the Agency was that any additional services they could include in the contract would have to be consistent with the original advertisement in the Official Journal of the European Communities. The Agency received legal advice that to vary their requirements beyond what could be reasonably considered to have been included within the original advertisement would risk legal challenge. This demonstrates the importance of ensuring that the wording of such advertisements is carefully considered to allow flexibility in determining the final services to be contracted for.

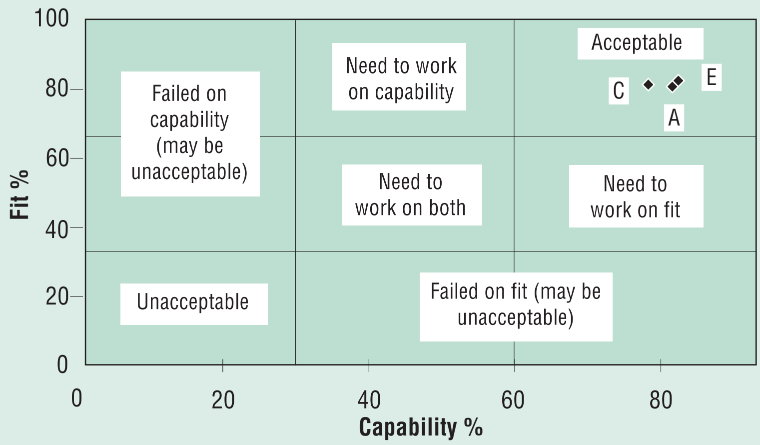
1.34 We recognise the wish of the Agency to ensure that competing bids were based on supplying broadly the same set of services considered to meet their business needs and believe that the Agency were also successful in maintaining the scope for innovation in bids. There is, in general, a tension between reducing competing bids to a single set of services and maximising the opportunity for innovation. Judgements need to be made at appropriate levels, as in this case, about the relative merits of competing proposals, even though such merits may not always be capable of evaluation in monetary terms. This is now the approach recommended by the Private Finance Panel.

The final bids were compared on a common basis and the economically most advantageous bid was chosen

There was little to choose between the competing bids in terms of the scores given to the business and technical solutions

1.35 The final bids were evaluated against the same criteria used for the initial proposals. All three bids had increased their scores on both capability and fit and were therefore judged compliant with the Contributions Agency's requirements (Figure 6).

Figure 6: Final scores attributed to different bids following the evaluation of best and final offers



Bidders	Capability	Fit
Andersen Consulting (A)	82	83
CSC (C)	78	84
EDS/SEMA (E)	83	85

Source: The Contributions Agency

There was little to choose between the three bids in terms of capability and fit.

1.36 Although there was little to choose between the scores achieved by the three bids there were differences in the detail of the individual proposals. The most significant of these were the different dates given for when NIRS1 would be fully replaced and the amount of the Department's accommodation the supplier wished to use. Wherever possible, the Contributions Agency quantified all such differences to arrive at comparable final bids.

1.37 The three suppliers all proposed different delivery dates, the key date being that from which NIRS1 was to be replaced. The proposed dates were:

- EDS/SEMA 28 October 1996
- CSC 16 December 1996
- Andersen Consulting 10 February 1997

The financial implications of the differing dates, and the fact that one bidder planned to use twice as much of the Contributions Agency's accommodation as either of the other two suppliers, were taken account of in the financial evaluations. All the suppliers continued to accept a sufficient allocation of risk, and the Contributions Agency considered the funding methods and financial guarantees provided by each to be acceptable.

The Andersen Consulting final price was much lower than the competing bids

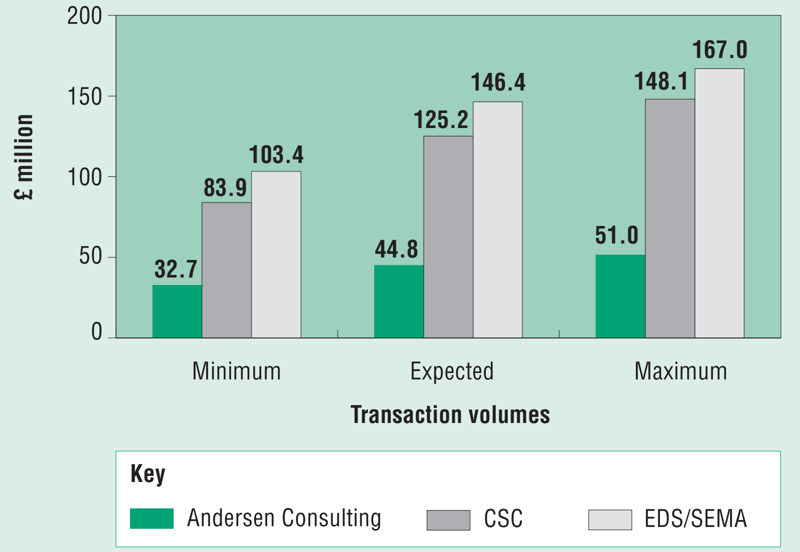
1.38 The financial evaluation of the final offers showed that Andersen Consulting's offer was very much lower than those of the other two bidders. The Evaluation Panel therefore recommended that Andersen Consulting should be awarded the NIRS2 Private Finance Initiative contract, and this was endorsed by the Project Board. The Contributions Agency also carried out sensitivity tests to establish the prices of the competing bids against different levels of activity. In all scenarios tested the Andersen bid maintained its significant price advantage. The net present values of the expected, minimum and maximum payments under each of the bidders' proposals are shown in Figure 7.

1.39 Andersen Consulting had reduced their bid so dramatically, when compared with their indicative prices, that the Contributions Agency approached them for an explanation. They explained that this was partly due to further work they had done since providing their indicative prices, but was primarily a commercial judgement.

The Contributions Agency took steps to ensure that the competition was conducted as fairly as possible

1.40 The procurement was conducted in accordance with the European Union procurement rules under the "negotiated procedure". While the companies were producing their proposals frequent contact was necessary with Agency staff to obtain additional information or clarification. The Contributions Agency decided that the best way to manage such contacts was to set up a small dedicated team of staff to assist each of the three companies. The three teams were housed in different locations. The suppliers all thought these arrangements

Figure 7: Expected, maximum and minimum net present values of the cost of the suppliers' NIRS2 bids, including the Transfer Payment, over the life of the NIRS2 contract



Source: The Contributions Agency

The price of the Anderson Consulting bid was much lower than the competing bids under all three scenarios.

worked well. It meant they had a clear point of contact who could quickly respond to questions, by contacting others in the Contributions Agency if necessary, or setting up meetings with relevant staff. We believe this to be a sensible approach to ensuring equality of information among competing bidders, an aspect of good practice in Private Finance Initiative procurements as in privatisations.

1.41 CSC and EDS/SEMA told us that they believed that the Contributions Agency had made every possible effort to ensure that Andersen Consulting did not have an undue advantage in the competition due to their previous involvement in the project. Nevertheless, they still believed that Andersen Consulting did retain some advantage, because of their prior involvement in the work from which the Statement of Service Requirement was derived. SEMA has also had some prior involvement with the Agency in providing support for NIRS1 and some early work on NIRS2, and EDS had had significant previous involvement in the development and running of the Department's computer systems. Andersen Consulting believe that the playing field was well and truly levelled by the Agency's actions. We are satisfied that the Contributions Agency did as much as was reasonable to limit any advantage that Andersen Consulting may have had from their prior involvement with the project.

Part 2: Value for money

2.1 Andersen Consulting are still developing the NIRS2 system. It is therefore too early to demonstrate the value for money of the procurement. Nevertheless, since there is a contract in place, it is not too early to form a view on the likelihood of value for money being achieved.

2.2 In general, value for money is likely to be achieved in a Private Finance Initiative contract if:

- the contract provides for the required service to be delivered;
- the deal compares favourably with the cost of alternative means of providing the same service.
- risks associated with the contract rest with those parties best able to manage them; and
- the contract has been won following a genuinely competitive procurement process.

2.3 This part of the report examines the NIRS2 deal against these four criteria and also what impact the delayed implementation is likely to have on value for money.

The contract laid down high level service requirements with detailed service levels left to be agreed later

2.4 The Contributions Agency carefully evaluated all the suppliers' proposals to ensure that they were in accordance with the Statement of Service Requirements and drew up a contract, with the help of their legal advisers, which incorporated those requirements. The contract included critical minimum service levels with an agreement to agree detailed service levels 30 days prior to the go-live date. The reasons for this were that, at the time the contract was signed, the exact solution to meet the Contributions Agency's needs had still to be determined - and the detailed service levels would depend to some extent on that eventual solution. The Agency recognised that there was a risk in not specifying detailed service level agreements in the contract itself but they considered it would be impractical and unnecessary to define detailed serviced levels two years ahead of implementation and in advance of an appropriate level of detailed functional and technical design. They were told by their legal advisers that this practice was not uncommon in relation to contracts to develop new information technology systems given the rapid developments which typically characterise such systems. The detailed service levels for the first release due in February 1997 were agreed in December 1996.

2.5 We recognise the advantages of leaving detailed service levels until nearer the time when the detailed solution is finalised but believe this also creates an opportunity for confusion and argument on exactly the quality of service that is contracted for. The judgement as to which is the best way to proceed is a fine one and each case should be considered, as in the NIRS2 case, on its merits and after appropriate consideration of the advantages and disadvantages of both approaches.

The winning bid was much cheaper than the estimated cost of a conventionally financed comparator

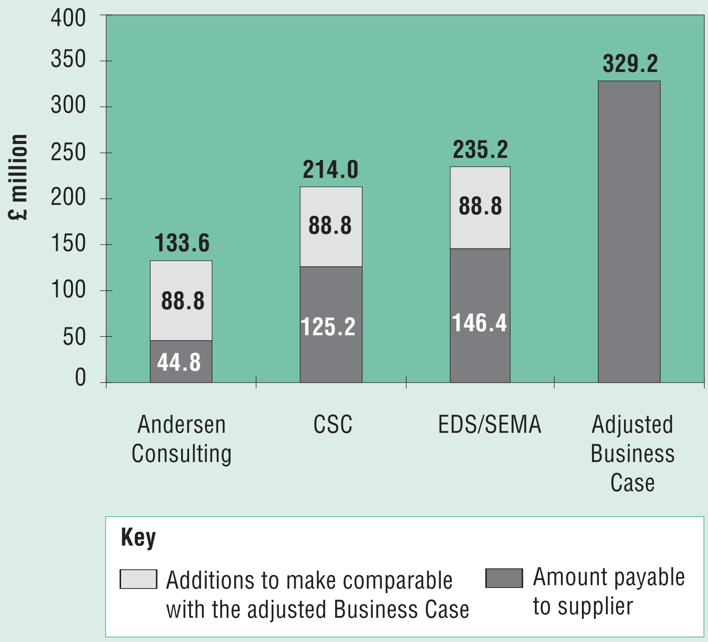
2.6 When the Business Case for the development, implementation and operation of NIRS2 by traditional means was prepared in 1993-94, the costs of the project were calculated over a ten year period. Although these costs included significant Contributions Agency staff costs, the bulk of the costs consisted of the charges Information Technology Services Agency would recover from the Contributions Agency for their work in developing and operating the system. These represented their full economic costs (i.e. including relevant overheads) and also included their capital costs which they would have recovered over a number of years.

2.7 To establish whether the bids from the suppliers offered value for money as a Private Finance Initiative scheme, the Contributions Agency decided to construct a proxy public sector comparator by using the costing information in the Business Case and making adjustments for changes in scope, the seven year contract period and for inflation. The main changes related to development work completed between the submission of the Business Case and the start of the evaluation of the Private Finance Initiative bids, and the inclusion of additional Agency systems in the Private Finance Initiative contract which were not included in the Business Case.

2.8 To compare the final offers with the total cost of the existing business case for a traditional procurement, other significant adjustments had to be made; the main adjustments were in respect of the cost of the Contributions Agency's and the Information Technology Services Agency's inputs to the new system which were included in the Business Case but were still required over and above the contract payments that would be made to the supplier.

2.9 Figure 8 shows a comparison of the Net Present Values of the expected payments that would be paid by the Contributions Agency under each of the suppliers' final offers (after certain adjustments to make them comparable, see paragraph 1.36) with the estimated cost of the adjusted business case. The cost of the Andersen bid at £133.6 million was some 60 per cent lower.

Figure 8: Comparison of the estimated cost of the adjusted Business Case with the Net Present Values of the expected cost of the suppliers' final offers for the NIRS2 contract



Source: The Contributions Agency

Note: Bidders prices include the proposed Transfer Payment

All bids received offered significant savings when compared with the estimated cost of the adjusted Business Case.

2.10 The Business Case costing was originally produced to seek approval to the project from the Department and the Treasury, rather than as a public sector comparator. The costing could not take into account the impact of the subsequent Information Technology Services Agency outsourcing of their service delivery operations as it was too recent for the benefits to be fully assessed. This outsourcing is expected to secure significant cost reductions. To this extent the use of the adjusted Business Case costing as a proxy for a public sector comparator can only provide a very broad indication of the difference in prices offered by the bids and the expected cost of traditional procurement. The Contributions Agency were well aware of this but decided, in view of the very large margin by which the bids were superior to the estimated conventional cost, that to construct a more accurate public sector comparator to take account of the expected benefits brought about by outsourcing would have been nugatory. We believe the Contributions Agency were justified in their approach.

Risks rest with those parties best able to manage them although a significant risk associated with late or non-delivery remains with the Department and the Contributions Agency

2.11 The Contributions Agency identified the risks associated with the project soon after Ministers agreed it should involve private finance. They drew up a risk register that has been regularly updated during the competition process and the development phase. When the short-listed suppliers had submitted their proposals, the Contributions Agency analysed the amount of risk that the bidders indicated that they were willing to take on, to establish that it was sufficient for the project to qualify for a Private Finance Initiative classification. One of the bidders told us that they thought that the Contributions Agency's initial approach was to try to transfer as much risk as possible which is now accepted by all concerned in Private Finance Initiative deals including the Private Finance Panel and HM Treasury not to be the way to maximise value for money. However, after negotiation they considered the final allocation was reasonable.

2.12 The procurement team, with advice from their financial advisers, attached an estimated value to each risk, where possible, and considered the balance of the risks as between the supplier and the Contributions Agency for each phase of the project and overall. This analysis also served the purpose of bringing out issues which needed to be raised with the suppliers before they were asked to submit their final offers.

2.13 The analysis showed that the main and significant risks that all the suppliers were prepared to take on were:

- the risk of developing a system and not being paid anything until it works;
- possible claims for compensation in the event of slippage or service failure;
- a service credit system which put at risk some of their revenue if they did not meet certain defined performance targets; and
- the risk that when the provision of NIRS2 is re-competed, the existing supplier will not receive a Transfer Payment if his system should lose to a new system.

2.14 The values the Contributions Agency determined for each of the risks they had identified at the time they received the final offers from the suppliers are set out in Figure 9.

The Contributions Agency is protected against volume risk thereby providing a limit on payments

2.15 The contract provides a ceiling for each of the 15 transaction types above which Andersen Consulting will cease to receive additional payments. The contract also provides for certain future changes to the system to be included in the basic charge. These changes are those required as a result of regular amendments in social security or pensions legislation, such as the annual changes to contribution rates; those required as a result of the pension reform legislation; and other minor changes which are well defined in technical terms. There is a possibility that there will be disagreement between the Contributions Agency and the contractor as to whether a particular change can be categorised as a "customary change", but they believe there is unlikely to be any significant problem.

Not all delivery risk has been transferred

2.16 The contract provides for Andersen Consulting to pay substantial compensation to the Contributions Agency should Andersen Consulting fail to deliver the required system. This arrangement transfers the financial consequences of delivery risk to Andersen Consulting and provides them with a strong incentive to deliver on time. However, failure of Andersen Consulting to deliver the replacement for NIRS1 will have a major impact on the ability of the Contributions Agency and the Department to carry out their statutory functions. This element of delivery risk could not be transferred to the supplier and therefore remains with the Agency.

The procurement process was competitive throughout

2.17 Part 1 describes the competition that took place for the NIRS2 contract. It is clear that a genuine competition took place throughout the process. All proposals put forward met the Contributions Agency's high level requirements and there was little to choose between the technical quality of the competing bids. All three suppliers were kept in the competition until a very late stage thus ensuring that competitive pressure was maintained. Finally, the contractor offering the lowest price for the services required, Andersen Consulting, was selected and final terms were agreed within a month of the receipt of best and final offers from all three suppliers.

Figure 9: Transfer of risk - evaluation method and value calculated by the Contributions Agency, based on the original contract (a)

Type of risk	Valuation method for Contributions Agency risk	Value of Agency share (£m)	Percentage of total for that risk	Valuation method for supplier risk	Value of supplier's share (£m)	Percentage of total for that risk
Development phase						
Delayed Go-live	Contingency cost analysis	0.11	0.7	Additional resources to complete task; lost NIRS2 revenue; and continued NIRS1 revenue less than actual operating costs.	14.75	99.3
Development cost overruns	None	0.00	0.0	Additional resources to complete tasks on time.	7.01	100.0
NIRS1 unavailable	Non-recoverable additional clerical costs	1.15	20.1	Additional resources to restore service and maximum NIRS1 service credit deduction.	4.57	79.9
NIRS2 failure	None - no different from public sector financing option	0.00	0.0	Loss of capital cost.	93.20	100.0
Operational phase						
Low volumes (b)	Minimum charge paid versus theoretically lower charge	3.26	38.4	Minimum charge received versus expectation of median forecast charge.	5.23	61.6
Enhancements	Cost of "non-customary enhancements	9.94	30.9	Cost of "customary" enhancements.	22.28	69.1
System performance	None	0.00	0.0	Maximum service credit deduction plus cost of resolving faults not covered by the Service Level Agreement.	16.16	100.0
Inflation	None	0.00	0.0	Inflation higher than expected.	Not valued	100.0
Re-competition						
New solution selected at re-competition	None	0.00	0.0	Loss of transfer payment.	8.29	100.0
Contract management						
Risk transfer	Contractor shifts risks he has assumed back on to the Contributions Agency	Not valued	100.0	None	0.00	0.0
Termination						
NIRS2 no longer required	Termination payment must be paid to the contractor	0.00 (c)	0.0	Transfer payment may be less than profit lost.	Not valued	100.0
Total risk values		**14.46**	**7.8**		**171.49**	**92.2**

Notes: (a) The revised implementation timetable changed the value and share of the risks marginally to the following:
Contributions Agency £14.63 million (8.3 per cent) Andersen Consulting £160.97 million (91.7 per cent)

(b) High business volumes are not considered to be an Agency risk as the contract includes a capping mechanism.

(c) The Contributions Agency would have been faced with a similar risk (in the form of an investment write-off) if NIRS2 had been procured with public sector finance.

Part 3: Contract management and changes to the delivery timetable

3.1 This part of the report examines the Contributions Agency's arrangements for monitoring the NIRS2 contract and their response to and the impact of the delayed implementation of NIRS2.

In the absence of central guidance, the Contributions Agency have devised their own monitoring arrangements

3.2 Currently no central guidance has been issued about contract management for Private Finance Initiative information technology projects. The government's Central Information Technology Unit, part of the Cabinet Office with responsibility for advising Ministers on the government's information technology strategy and advising departments on the use of private finance in information technology projects, told us that they have issued case studies to supplement guidance issued by the Private Finance Panel. They also told us that Departments are aware that guidance issued by the Central Computer and Telecommunications Agency on the procurement and management of information technology services is applicable to Private Finance Initiative projects.

A contract management team and NIRS2 User Group were established

3.3 The Contributions Agency turned their attention to contract management soon after NIRS2 became a Private Finance Initiative procurement in July 1994. Before the contract was awarded to Andersen Consulting, the nucleus of the team that had conducted the procurement competition was given responsibility for the contract management. The Agency has found this approach to be a distinct advantage. Their responsibilities included:

- aiding the smooth transition of the responsibility for the operation, support and maintenance of NIRS1 and associated systems from the Information Technology Services Agency to Andersen Consulting;

- ensuring that Andersen Consulting meet their contractual obligations on time and to a level of quality acceptable to the Contributions Agency;

- ensuring that the developing system accurately reflects the users' requirements; and

- developing, in conjunction with Andersen Consulting, a service level agreement, a service credit scheme and the NIRS2 acceptance criteria.

3.4 Their responsibility to transfer NIRS1 was successfully accomplished and Andersen Consulting took over full responsibility for that system on 1 November 1995. Also on that date, 119 staff of the Information Technology Services Agency (of whom 80 were permanent staff) were transferred to Andersen Consulting. The Contributions Agency took appropriate action to ensure that the staff who transferred retained the same conditions of service in accordance with the Transfer of Undertakings (Protection of Employment) Regulations.

3.5 The Contributions Agency have also set up a NIRS2 User Group to be responsible for all users' interests, including the specification, clarification, design and user testing of the sub-systems and ensuring appropriate training is provided for the staff of the Contributions Agency.

The terms of the contract provide specific contract management arrangements

3.6 The original agreement with Andersen Consulting included an Implementation Plan with dates for meeting certain contractual milestones. A number of these contractual milestones required Andersen Consulting to produce more detailed plans in respect of Migration, Transition, Testing and Implementation. These were revised by the Deed of Variation to the contract after the phased approach for the implementation of NIRS2 had been agreed. Reporting arrangements were strengthened with the introduction of additional contractual milestones and a simpler reporting format.

3.7 The NIRS2 contract sets out the objectives for contract management and how they will be achieved. For example it states that there should be regular meetings between Andersen Consulting and the Contributions Agency at various levels and states what access the Contributions Agency team should have to Andersen Consulting's plans. The contract also gives the Contributions Agency significant powers to quality assure particular products.

3.8 From the award of the contract up until April 1996, Andersen Consulting and the Contributions Agency each produced a monthly progress report for the Contributions Agency's NIRS2 Project Board, renamed as the NIRS2 Programme Management Board after the contract had been awarded. Since September 1996 the two reports have been amalgamated. Andersen Consulting produce the report with Agency staff supplying information on the aspects of the project for which they are responsible. Internal Audit continue to be involved in reviewing Andersen Consulting's progress. Regular mid-stage assessments have been held, and the Programme Board reviews progress on the recommendations of these when it meets.

Some contract management issues were left to be agreed after the contract was signed

High level service requirements are included in the contract

3.9 The contract includes a high level, framework service requirement, with an agreement to finalise detailed service levels 30 days before the implementation date. The minimum service levels specified in the contract are those which are crucial to the operation of the Contributions Agency's business. They include the following:

- the system is to be available from 7.00 a.m. to 9 p.m., every day of the year excluding Christmas Day;
- the response times of the system are to be 95 per cent of all transactions within seven seconds and 99 per cent within ten seconds;
- 98 per cent national availability for each full on-line service measured on a weekly basis;
- 99 per cent availability for each full on-line service over a "rolling" 13 week period; and
- in the event of the system breaking down, the main service should have a skeleton service capability within two working days, and full service capability within five.

3.10 In preparation for the original replacement date of February 1997 for NIRS1, the Agency's contract management team did some preliminary work on the development of a Master Service Level Agreement. However, before they could finalise their views, Andersen Consulting proposed the revised implementation timetable. It was therefore inappropriate for the Agency to negotiate further with Andersen Consulting on the Agreement until the terms of the variation to the original contract became clearer.

3.11 Once the revised implementation timetable was agreed, the Agency's contract management team gave Andersen Consulting their views on the Master Service Level Agreement. Under the revised contract timetable, Andersen Consulting were required to produce their view of what the service levels should be for the first release by 10 September 1996 with a view to agreeing them within three months. Agreement was reached by the due date of 10 December.

3.12 There is one case where the Agency have agreed to a relaxation of the high level service requirements included in the contract for response times (10 seconds as compared to 7 seconds). The Agency told us that they have agreed to the slower response time for this first release stage which is considered to be non-business critical. However, the agreement makes it clear to Andersen Consulting that this does not set any precedent for future releases. For later releases the Deed of Variation states that if agreement cannot be reached over service levels those in the original contract should take effect. Andersen Consulting told us that they fully accept that the contracted service levels should apply during the operational phase of the contract (from April 1998 onwards).

3.13 The contract provides for the Agency to make payments for the replacement system once they are satisfied that it is operating in accordance with the requirements set out in the contract. Although the contract requires "acceptance procedures" to be performed it does not specify exactly what tests should be undertaken, but only that agreement on the "acceptance criteria" should be achieved by certain dates. The Agency reached agreement with Andersen Consulting in October 1996 on the acceptance criteria for the first release in February 1997 and are confident that they will be able to agree the criteria for future releases.

Important details of performance monitoring were left to be agreed after the contract was signed

3.14 The contract obliges Andersen Consulting to measure performance against targets and, where appropriate, against the minimum service levels specified in the contract. Reports on performance are to be provided to the Contributions Agency and the Agency will have the facility to audit the source of Andersen Consulting's performance reporting information. If Andersen Consulting do not meet the service levels already specified in the contract or those still to be agreed, the Agency will be entitled under the contract to service credits, that is amounts which are deducted from the monthly payments due to Andersen Consulting. The basis for calculating the service credits for the first release due on 10 February 1997 was agreed between the Agency and Andersen Consulting on 7 February 1997.

The contractor must pay damages for late delivery or poor performance of the system and the Agency is protected in the event of the financial failure of Andersen Consulting

3.15 The contract states that if Andersen Consulting fail to fulfil an obligation, as set out in the Implementation Plan, they are required to arrange all such additional resources as are necessary to fulfil that obligation as early as possible at no additional charge to the Contributions Agency.

3.16 The contract also allows the Agency to terminate it if Andersen Consulting are in default of any obligation under the contract and fail to remedy it within 30 days. In such circumstances they can require Andersen Consulting to provide for the provision of facilities and for services equivalent to the services covered by the contract by the Agency itself or a third party. The limit on the amount Andersen Consulting might have to pay in such circumstances is £100 million during the development phase and £2 million per event during the operational phase up to a maximum of £50 million in any 12 month period. The Agency do not believe that higher figures for the limits could be justified as the agreed levels would be sufficient to cover the Agency's maximum loss.

3.17 The contract provides the Agency with a perpetual, royalty-free, world-wide irrevocable licence in respect of all software, documentation and intellectual property rights relating to the NIRS2 agreement. Also, if requested by the Agency, the contract provides for Andersen Consulting to place in escrow a copy of the coding for all NIRS2 software with the National Computing Centre.

3.18 The Agency's financial advisers carried out checks on the funds available to Andersen Consulting. In the event of financial failure of Andersen Consulting, the Contributions Agency have the benefit of a financial guarantee provided by the Arthur Andersen & Co. S.C. (a Swiss Société Cooperative) on behalf of the Arthur Andersen Worldwide Organisation and a covenant from Andersen Consulting A, a United Kingdom partnership.

The revised timetable does not greatly affect the value for money of the deal but has reduced the available contingency margin

Within 8 months of contract award Andersen Consulting proposed a revised approach to implementation

3.19 In November 1995 the Agency received some indications that all was not well with the project. For example, a mid-term assessment report (one of four provided for in the contract) produced in November 1995, noted that progress on certain key aspects was behind schedule. In January 1996, during one of the regular meetings with the Chief Executive of the Information Technology Services Agency, it became clear that Andersen Consulting had realised the system size and scope were bigger and more complex than originally thought. They had therefore concluded that delivery of NIRS2 in accordance with the contract timetable was not the best approach and that a phased approach would be more appropriate. They believed a phased approach would bring both less development risk to themselves and less business risk to the Agency and that it was therefore responsible, under a Private Finance Initiative contract involving a long term relationship between the parties, to suggest an alternative strategy.

3.20 A meeting between Andersen Consulting and the Contributions Agency followed soon after, and Andersen Consulting wrote formally at the beginning of February to set out their views on the best way forward. The Agency felt that Andersen's views did not comply with the original advertisement, did not represent a viable basis for agreement of an alternative release strategy and involved an unacceptable transfer of risk back to the Agency. Throughout the discussions which took place, Andersen Consulting insisted they could, if necessary, deliver to the original timetable although they considered it would be in the best interests of both parties if the approach was changed. At the end of February they submitted a revised implementation plan on a "without prejudice" and unsolicited basis for consideration by the Agency.

The Contributions Agency chose to accept the revised implementation within the existing contract structure

3.21 The Contributions Agency's view was that the Andersen Consulting proposal left them with four options:

(1) Require Andersen Consulting to deliver NIRS2 to existing contractual milestones;

(2) Negotiate freely with Andersen Consulting on their proposal;

(3) Agree acceptable slippage within the current contract structure; and

(4) Terminate the contract with Andersen Consulting and seek a new supplier.

3.22 The Agency did not consider Option 1 to be realistic as they retained significant doubts over whether Andersen Consulting could deliver to the original timetable despite their assurances. They considered Option 2 to be inappropriate as it was felt this would lead to a new contract and effectively mean that the Private Finance Initiative principles had been breached. The Agency considered Option 4 impractical as it would introduce even greater delay and they felt that they had received a very favourable deal on price from Andersen Consulting which was unlikely to be repeated in a new competition. Because of the importance of the system to the Agency, the proposed pension reforms as well as the Private Finance Initiative more generally, Departmental and Treasury Ministers met Andersen Consulting to discuss the situation. They obtained assurances that Andersen Consulting would provide the necessary support for the pension reforms by October 1997. Taking into account the value for money which the revised proposal still represented and the perceived risks of insisting that Andersen Consulting deliver to the original timetable, the Department decided to accept the proposal subject to legal opinion that it could be accommodated within the contract structure. To re-open the competition at this late stage would not only bring major delays to the implementation of the new system with its consequent impact on the pension reforms but would also be seen as a major setback to the Private Finance Initiative more generally. After taking advice from leading Counsel, and following further negotiation and consideration by Ministers on the improved proposal, the Agency signed a Deed of Variation to the contract in July 1996.

The revised proposal was evaluated against the criteria used during the initial competition

3.23 The Andersen Consulting improved proposal was evaluated in accordance with the criteria used for the original proposals from the three bidders. The scores achieved were 59 per cent for fit and 66 per cent for capability. It was considered that further clarification, as took place in relation to the original proposals, would have been likely to have improved the score achieved. The conclusion of the evaluation panel was that the revised proposal at that time was "on the margin of acceptability".

The balance of risk between the parties is unchanged

3.24 The procurement team evaluated the effect of the changes to the contract on the allocation of risk between the Contributions Agency and the supplier and concluded that the balance had not changed by any significant amount. Andersen Consulting can still suffer severe financial penalties if they do not deliver an operational system in accordance with the revised implementation dates.

3.25 However, the phased approach means that for some time some data will have to be held on both systems at the same time with the risk that it will not be updated on both at the same time. For this reason the Agency's view was that, while the project was high risk irrespective of the solution chosen, it would be less risky for NIRS2 to replace NIRS1 totally at one time. However, they accept that the nature of a Private Finance Initiative contract, which involves the transfer of risk, means that the contractor has to be left to make his own judgement as to how best to develop the new system. The phased approach also means that support for the government's pension reform legislation will be available later than specified in the original contract, although Andersen Consulting assured the Agency that they would be able to support the legislation in time using a combination of the existing NIRS1 and the available parts of the replacement system. Further slippage will put the reforms at risk, as the Agency believe the scope for using further contingency beyond April 1998 is extremely limited . The revision does not have any significant impact on the cost of the contract itself, but the Agency's own costs have increased by an estimated £3.8 million and there are also potential estimated lost savings to both the Contributions Agency (£4 million) and the Benefits Agency (£2 million), because of the delay in the implementation.

The price of the deal is unchanged and compensation is being paid for the delay

3.26 No payment will be made to Andersen Consulting for NIRS2 until it is fully operational. Andersen Consulting told us that this would cost them some £8 million in lost revenues, that the additional cost of developing the phased approach would be a further £8.5 million and that the net cost of running the existing NIRS1 system until April 1998 would be £3.5 million. Also, Andersen Consulting have agreed to pay compensation of up to £3.1 million to the Contributions Agency for the additional costs to them resulting from the delay in full implementation. This amount will be phased over the period until the replacement system is fully implemented and will be offset against the payments due to Andersen Consulting under the NIRS1 contract. This phasing of the compensation provides Andersen Consulting with an incentive to complete the development and implementation as early as possible.

3.27 The compensation to be paid by Andersen Consulting will not be sufficient to cover the loss of the potential savings accruing to the two agencies as a result of the delayed implementation. However, the Agency did not believe it would be possible to get Andersen Consulting to compensate them for such lost savings, and we note that, had the system been developed in the traditional way, the cost of all delays would have been borne by the Agency. From this perspective the receipt of any compensation can be seen as a positive impact of the Private Finance Initiative.

The Contributions Agency had contingency arrangements to address the risk of problems occurring during the development phase of the project but these proved insufficient

3.28 We considered whether the slippage experienced by Andersen Consulting was due to deficiencies in the contract management arrangements. We concluded that the arrangements were appropriate and that contingency arrangements provided for slippage of 10 months (from February 1997 to December 1997) in a 23 month development project. On the one hand because this was a Private Finance Initiative project involving the transfer of risk, it would have been inappropriate for the Contributions Agency to monitor unduly closely everything that Andersen Consulting were doing. On the other hand the Department and the Agency were also exposed to significant risk in the event of delayed or non-delivery because of the impact this would have on their ability to deliver the new pension arrangements. In the event although contingency arrangements were in place to deal with significant development delays these proved to be insufficient to cope with the eventual level of slippage experienced.

Appendix 1

National Insurance contributions

1 The National Insurance Fund was set up under the provisions of the National Insurance Act 1946. The Fund receives contributions payable by employers, persons insured under the Act and the Exchequer to meet the costs of certain social security benefits and other payments, and of administering the Act. The bases on which contributions have been payable have varied over the years. Currently, Class 1 contributions are payable by employees and employers at specified percentages of the employees' earnings; Class 2 contributions are payable by the self-employed at a flat rate; Class 3 contributions are paid voluntarily at a flat rate by those not liable to pay contributions of another class (for example by people no longer in work or seeking work); and Class 4 contributions are payable by the self-employed, in addition to Class 2 contributions, at a specified percentage of annual profits between certain limits. In 1995-96 some £45 billion was collected in contributions.

2 In return for having paid contributions employees and Class 2 and Class 3 contributors may be entitled to social security benefits paid from the National Insurance Fund, and in some cases their spouses may also receive benefits. Benefits payable from the National Insurance Fund are known as "contributory benefits". The main contributory benefits are Retirement Pensions, Widows Benefits, Incapacity Benefit and Job Seekers' Allowance. To safeguard individual contributors' entitlement to benefits the Contributions Agency compile and maintain a permanent record for each insured person.

Responsibility for the National Insurance Scheme and Fund

3 The Department of Social Security are responsible for advising Ministers on policy relating to the National Insurance Fund. The Contributions Agency operates on behalf of the Department that part of the National Insurance Scheme dealing with the collection and recording of National Insurance contributions. To carry out this operation the Agency have to:

- ensure compliance with the law in respect of National Insurance contributions;
- maintain individual National Insurance records;
- provide an effective and efficient service to the Agency's customers who are:
  - Ministers
  - members of the public
  - other parts of the Department
  - other Government Departments
  - the business community generally
  - the pensions industry

4 The Agency's operations are heavily dependent on information technology and include one of the largest computer systems in Western Europe on which the records of each individual's National Insurance contributions are maintained.

Information Technology Services Agency

5 Another Agency of the Department, the Information Technology Services Agency, provides either directly or through contracts with the private sector, the information technology services required to deliver the Department's and the Agency's social security responsibilities. The Agency also at the time of the NIRS2 procurement, through the Departmental Information Technology Authority, provided a strategy for the Department's information technology, defined policies and standards, and through its procurement policies and processes managed and regulated the competitive supply of information technology.

Central Information Technology Unit

6 This Unit was established by the Government in December 1995 within the Office of Public Service, which is itself part of the Cabinet Office. Its principal task is to advise Ministers on the development of the Government's information technology strategy, in order to improve service delivery to the public and improve the

efficiency of government administration. Since 1995, the Unit has been responsible for advising Departments on the Private Finance Initiative in information technology projects.

Private Finance Panel Executive

7 The Private Finance Panel Executive was established by the Government in November 1993 as a limited company wholly owned by the Treasury. Most of their staff are seconded from the private sector. The role of the Executive is to promote the introduction of private management and finance into areas of capital investment and services traditionally undertaken by the public sector. One of the ways they do this is by advising Departments on Private Finance Initiative projects (excluding information technology).