NIRS 2: Contract extension

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL
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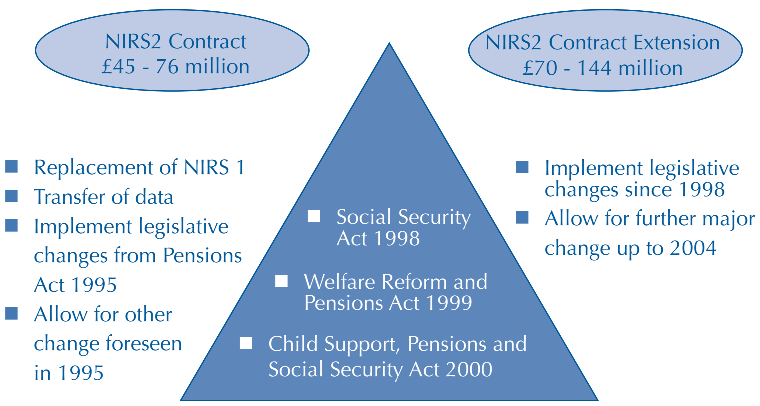
executive summary

1 NIRS 2 - the National Insurance Recording System - is a large and complex computer system designed to support the Inland Revenue's administration of the national insurance scheme. It was developed under the Private Finance Initiative to replace the previous National Insurance Recording System (NIRS 1). The Contributions Agency, then part of the Department of Social Security, was responsible for the development project. Following a competition, the Agency awarded the NIRS 2 contract to Accenture - then Andersen Consulting - in 1995. The contract covered the replacement of NIRS 1, transfer of data to the new system, development of the system to implement legislative changes arising from the Pensions Act 1995, and the operation of the new system until 2004.

2 In 1998 the Government proposed significant changes to pensions and national insurance legislation, for example to introduce stakeholder pensions and pension sharing on divorce. The Inland Revenue, who had taken over responsibility for NIRS 2 in April 1999 with the transfer of the Contributions Agency, negotiated an extension to the contract to cover the work needed to support these legislative changes. The original contract was valued at £45 million for operational services with provision for software enhancements increasing that to £76 million. The estimated value of the extension is between £70 million and £144 million, depending on the amount of work ordered over the remaining life of the contract. On the basis of development work ordered and planned to date, the Department's current estimate is for substantially less than £144 million **(Figure 1)**.

1 National Insurance Recording System contracts



3 We carried out a study of the extension to the NIRS 2 contract in order to ascertain:

- why the Department needed to contract for additional development work beyond the scope of the original contract;
- what options were available to the Department for carrying out the additional work, and how these options were evaluated;
- how the Department evaluated the proposal submitted by Accenture in the absence of open competition;
- whether risks were shared appropriately between the parties to the contract; and
- what steps the Department had taken to ensure that the problems arising under the original contract are not repeated during the course of the additional work.

4 We decided to issue this report for two reasons:

- to consider, on the basis of the NIRS 2 experience, the extent to which private finance initiative (PFI) contracts can provide the flexibility to accommodate changes in government programmes and practice that flow from government policy developments; and
- to review developments on the NIRS 2 contract with Accenture following our initial examination[1] and the subsequent reports by the Committee of Public Accounts.[2] NIRS 2 is a major project, supporting the Inland Revenue's administration of the national insurance scheme, holding details of 65 million national insurance contributors and calculating benefits and other amounts payable, such as state pensions. A project of this size and importance is a matter of continuing public and Parliamentary interest.

5 The report does not cover the implementation or operation of the original system, progress with which is being monitored as part of our annual audits of the National Insurance Fund account.

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1 HC12, Session 1997-98

2 The contract to develop and update the replacement national insurance recording system (46th Report, Session 1997-98 (HC472))

Delays to the new national insurance recording system (22nd Report, Session 1998-99 (HC 182))

National Insurance Fund 1998-99 (31st Report, Session 1999-00 (HC 350))

The original NIRS 2 contract proved insufficiently flexible in catering for the significant legislative changes to pensions and national insurance proposed by the Government in 1998

6 The original NIRS 2 contract included provision for system development work to meet foreseeable legislative changes. There was an annual limit to the quantity of system enhancements which could be ordered at the agreed price, based on the Contributions Agency's experience in operating the previous National Insurance Recording System. The pricing arrangements for system enhancements were finalised after the contract award.

7 In 1998, the government proposed changes to pensions and national insurance legislation on a scale which considerably exceeded the level expected when the contract was agreed. The Department of Social Security had provided advice to Ministers on the technical feasibility and costs of each of the policy changes. The implications of each policy were, however, assessed separately, and the Department's ability to assess the capacity of NIRS 2 to accommodate the overall package of changes within the proposed legislative timetable was limited by uncertainties about the initial stabilisation of the system, and the lack of clarity around the timescales for these changes. This meant that they were not in a position to establish fully the aggregate effect of the changes on NIRS 2.

8 At the point when the Inland Revenue took over responsibility for NIRS 2, it was unclear whether the contract contained sufficient headroom to cater for the development work needed. They therefore worked with the Department of Social Security, Accenture and EDS to determine the volume of new work required by the legislative changes, for which responsibility was now shared between the two departments, and the feasibility of delivering it through NIRS 2. The Inland Revenue concluded that the scale of the new work exceeded the contract limit and decided to examine how best to meet the commitments.

The extension of the NIRS 2 contract

9 The Inland Revenue looked at alternatives to using NIRS 2 to support the new legislative requirements, including clerical solutions and using other information technology systems. Most of these were rejected because they were not technically feasible or likely to involve greater risk or cost than enhancing NIRS 2. They concluded that NIRS 2 was the most practicable option for some 80 per cent of the work required.

10 The Inland Revenue had three main contractual options for commissioning the new NIRS 2 development work:

- to negotiate a contract extension;
- to ask Accenture to provide the additional resources required at Department of Social Security framework rates, under the original contract terms;
- to exercise the break clause in the original contract and hold a new competition for the continuing operation and development of the system.

11 They opened discussions with Accenture about extending the contract. In response, Accenture offered to deliver all development work using a dedicated software support facility. Doing this and introducing longer-term planning of resource requirements would enable them to offer a lower price for enhancements than the Department of Social Security framework rates, which were the alternative charging mechanism.

12 The Inland Revenue then commissioned PA Consulting to develop a financial model to compare the cost of Accenture's proposals with that of using alternative suppliers. The work showed that Accenture's unit costs compared closely with the comparators, but breaking the NIRS 2 contract would have incurred additional costs estimated at £44 million. The results therefore supported the option to extend the contract with Accenture.

13 In addition to the financial evaluation, the Inland Revenue assessed Accenture's ability to deliver software of the required quality, the firm's commercial stability, legal, commercial and security issues, the legislative timetable, and the scope to improve their management of development work. After taking these factors into account, as well as a technical review of NIRS and latest Treasury guidance the Inland Revenue concluded that a contract extension provided the best option for meeting the legislative requirements in the timescale required.

14 The Inland Revenue used the extension to the contract to introduce new operating arrangements to resolve difficulties arising on the original contract which had contributed to delays in implementing the system. In doing so, they obtained legal advice that the extension complied with European procurement rules in all respects other than that the new payment arrangements to improve their control of development work did not strictly adhere to the terms of the original procurement advertisement. The advice recognised that this might give rise to claims for compensation from other suppliers, but that the risk of challenge was extremely low. However, the alternatives would not have allowed them to meet the timetable prescribed by new pensions legislation, which was already in force. They decided to proceed, as they considered that the costs of delaying the work programme and the advantages of the revised arrangements outweighed the risks attached to not complying fully with the procurement rules.

15 Under the new arrangements, Accenture continue to bear risks relating to the operation and availability of the system. The risks associated with system enhancements, however, are shared to a greater extent than under the original contract. The contract extension has introduced stage payments linked to the achievement of milestones, productivity incentives, and profit sharing arrangements.

16 The Inland Revenue have recognised that, in any relationship of this kind, it is not possible to transfer the business risk of non-delivery to the contractor. They have therefore strengthened arrangements for managing delivery risks by introducing their own project management methodology to the contract. This includes a system that ensures developments to the system are managed as a series of projects, which are overseen centrally and allocated a specific release date linked to the legislative timetable. There are joint working arrangements to secure increased collaboration and acceptance criteria are defined more clearly than before. The management arrangements for the contract extension correspond closely to subsequent government guidance on risk management in PFI contracts and IT projects.

17 The Inland Revenue and Accenture consider that their relationship has improved since the contract extension, due to the introduction and operation of partnership principles. Both sides describe the current relationship as open, trusting and effective in managing the contract, and have seen advantages accruing since the new arrangements were introduced. System changes required to support pensions sharing on divorce, changes in bereavement and incapacity benefits and the restructuring of national insurance contributions have been delivered successfully. The Inland Revenue reported that the NIRS 2 service had improved significantly since the new arrangements had come into operation and user satisfaction increased substantially. In the 12 months to 31 March 2001 service levels had consistently exceeded target performance and 2 major releases of high quality software had been made on schedule.

Conclusions and recommendations

18 The key points arising from our examination are as follows:

On the need for an extension and the lessons for Departments

a The original NIRS 2 contract between the Department of Social Security and Accenture included flexibility to cater for legislative change then planned, an agreed annual volume of additional development work and routine enhancements. But the scale of change arising from new legislation in 1998 was considerably beyond the level expected when the contract was agreed, and exceeded the levels allowed for in the contract. *Departments should consider whether contracts should include specific mechanisms to deal with major enhancements of this nature. This might involve the reintroduction of competition or inviting the bidders to propose a separate pricing structure for major enhancements as part of the initial tendering process.*

b The Department of Social Security did not assess the aggregate impact of the proposed policy changes and their timing on NIRS 2 development capacity. At the point when responsibility for the system was transferred to the Inland Revenue, neither Department had a clear view of whether there was the technical or contractual capacity to deliver the changes using the system. *In advising Ministers on the implications for existing information technology systems of fixing deadlines for major legislative change, Departments need to understand the impact on their systems, individually and in aggregate, and develop strategies to manage the resulting risks.*

c When the original NIRS 2 contract was concluded in 1995, there was little experience of the Private Finance Initiative and none in the field of information technology. An information technology procurement contract of this scale and complexity presented challenges in estimating the size of the requirement and developing pricing strategies which had not arisen in other Private Finance Initiative deals at the time. The Government have produced substantial additional guidance on such arrangements since 1999, in the light of experience with this and other contracts, which includes the following advice:

- *Change control, and similar procedures should be agreed at the outset and allow open discussion about the volume and cost of developments. Contracts should set out clearly how acceptance will be defined.*
- *Departments should avoid agreements to agree in key areas of contracts.*

The latter point is particularly important because attempts to conclude such agreements may be complicated, difficult and expensive and, in the extreme, may result in a material diminution in the value of a contract to a Department.

On the contract extension

d A contract extension offered better value for money to the Inland Revenue to deliver the required enhancements within the timescale required than the alternatives available.

e In deciding to implement the new contractual arrangements, the Inland Revenue took into account legal advice that the new payment arrangements might leave them vulnerable to claims for compensation. As the risk of challenge was extremely low they decided to proceed in order to meet the proposed timetable for new pensions legislation and to secure improvements in their control of development work. *Legislative timetables should be set so that Departments can implement changes while complying with other legal requirements.*

f The Inland Revenue contract management arrangements for the extension adhere closely to current guidance on risk management in PFI contracts and information technology projects. Had this guidance been available at the time, it would have led to contractual and operating arrangements considerably different from those originally adopted for NIRS 2. Risks associated with enhancements to the system are shared to a greater extent than under the original contract. The new arrangements have achieved improvements in the relationship between the parties and in the delivery of system enhancements, addressing weaknesses identified by the Committee of Public Accounts.