

Managing the relationship to secure a successful partnership in PFI projects



**REPORT BY THE COMPTROLLER AND AUDITOR GENERAL
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executive summary

- 1 The Private Finance Initiative (PFI) is now established as a major form of Government procurement. It is used to procure a wide range of public services, including hospitals, prisons, roads, computer systems and Government accommodation. There are over 400 PFI contracts currently in force committing departments to future expenditure of around £100 billion.
- 2 Although there is now considerable experience of the PFI procurement process, there is much less experience of the issues that arise once the contract has been let. Most PFI contracts are still in their early stages. It is important, therefore, that initial lessons arising from the management of these contracts, some of which relate to how the contracts were procured, are identified and disseminated quickly to authorities so that they can be taken into account in current and future projects.
- 3 This report highlights key issues which authorities need to keep in mind when developing and managing relationships with private sector PFI contractors.



The scope of the study

- 4 Our study has been based on surveys of authorities and contractors responsible for managing 121 PFI projects where contracts had been let prior to 2000. It is the first major examination of central government PFI projects in progress. The key question we have sought to answer is whether authorities manage their PFI relationships to secure a successful partnership. A successful partnership allows the participants to work together to achieve their objectives to their mutual benefit: the public sector receives a service that represents value for money; and the contractor delivers that service for a reasonable return.
- 5 The methodology we adopted to undertake the study, which included obtaining views from contractors as well as authorities, is set out in Appendix 1. The information presented in this report is based, except where otherwise stated, on the views of the authorities and contractors at the time of our survey (late 2000). Details of the projects surveyed are set out in Appendix 2. In the course of our study we also obtained the views of the Office of Government Commerce and various other public and private sector bodies active in the PFI field. We are grateful to all those who responded to our survey and contributed their views as our study progressed.

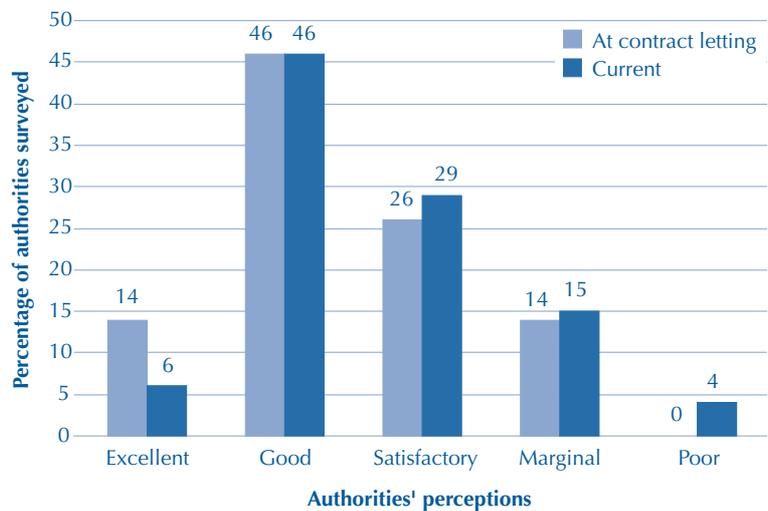
- 6 The study focussed on how authorities and contractors were managing the PFI contracts they had entered into. But how easy it is to create a successful partnership often depends on decisions made during, and often early in, the procurement process. Although this study did not examine in detail how the authorities procured their projects some of the results of our survey identified issues relevant to the procurement process.

Most authorities consider that their PFI projects are good value for money

- 7 We asked the authorities in our survey for their current perception of the value for money of their contracts. We also asked them how it matched up to their original expectations when the contract was let (Figure 1). Over half the authorities in our survey said that the value for money of their PFI projects was currently good or excellent. In total 81 per cent of authorities said that value for money was currently satisfactory or better, 15 per cent said it was marginal and 4 per cent said it was poor. There has been a slight decline, however, in perceived value for money since contracts were let. Some 86 per cent of authorities considered that the value for money of their PFI projects at the time of contract letting was satisfactory or better, 14 per cent said it was marginal and none said it was poor. There was generally positive feedback from users of the services although in some projects authorities and contractors were addressing areas where user feedback suggested improvements could be made.
- 8 These figures demonstrate the high expectations that authorities have for the success of PFI projects in delivering value for money in public services. But they also indicate that value for money is not guaranteed. Authorities need to ensure that the value for money anticipated at the time of contract letting is delivered in practice. To do so requires careful project management and a close attention to managing the relationship with contractors. Authorities also need to consult with users about their level of satisfaction with the services being provided. These important matters are addressed further in this report.

1 Authorities' perceptions of their projects' value for money

This is based on 98 authorities who gave us their perception of value for money at the time the contract was let, as well as at the time the survey was completed.

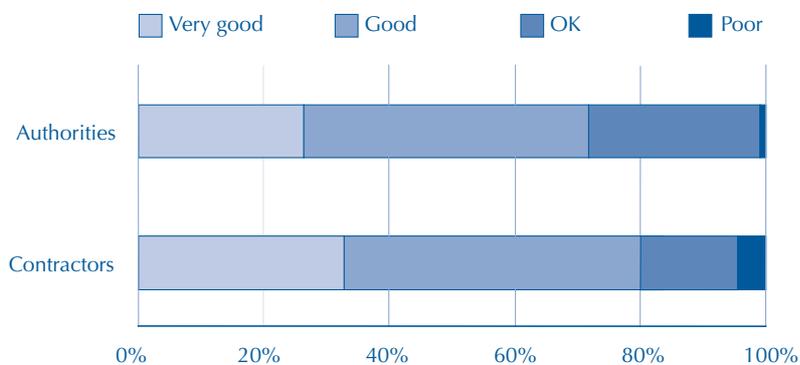


Source: National Audit Office survey of authorities

Most relationships between authorities and contractors are good

9 Our survey showed that 72 per cent of authorities and 80 per cent of contractors view their relationship as being good or very good. Very few (1 per cent of authorities and 4 per cent of contractors) consider that their relationship is poor (Figure 2). Some 45 per cent of authorities and 35 per cent of contractors said that their relationship had improved since contract letting. A much smaller number (18 per cent of authorities and 11 per cent of contractors) said that their relationship had worsened. These results suggest that authorities and contractors are making efforts to maintain a good relationship but that in a number of cases there is work to be done to improve relationships.

2 Authority and contractor view of current relationships



Source: National Audit Office survey of authorities and contractors

PFI projects need to be approached in a spirit of partnership

- 10 PFI projects involve long term relationships between authorities and contractors who, at first sight, appear to have inherently different objectives. A successful outcome for both parties can only be achieved if they are prepared to approach projects in a spirit of partnership. This requires an understanding of each other's business and a common vision of how best they can work together as partners.
- 11 Our survey showed that most authorities and contractors have made efforts to understand each other's businesses and to establish a shared vision for the project. On some projects, however, authorities and contractors have not taken steps to understand each other and establish common ground and this has often contributed to the subsequent development of an adversarial relationship.

A successful partnership needs to be established at the outset

- 12 Authorities and contractors need to consider how their relationship will be managed before contracts are let. Failure to do this can lead to misunderstandings and difficulties in the early years of the contract, a period which contains considerable risk as the required service is being brought into operation and the parties to the contract get used to working with each other. The Office of Government Commerce has issued best practice guidance on

'Managing Partnering Arrangements'. It outlines for senior managers the issues to be considered in managing partnering relationships, in PFI and other deals, and the key questions to be asked.

- 13** The development of a successful relationship between authority and contractor will be assisted by the right contractual framework. This will include allocating risks appropriately, establishing clearly defined quality of service and value for money mechanisms and building in arrangements to deal with change.
- 14** On these matters we found that:
- although most authorities are satisfied with the risk allocation in their PFI contracts only two-thirds of contractors shared the authorities' view that risks had been allocated appropriately;
 - virtually all contracts include clearly defined arrangements for assessing quality of service. In over half of these the authority had made performance deductions from the payments due to the contractor. There is also evidence that authorities and contractors are using performance review processes to bring about positive changes to the way that services are delivered;
 - many authorities had included mechanisms in their contracts which allow them to monitor or improve value for money although there is, as yet, very limited experience of making use of these mechanisms. Mechanisms most often included were benchmarking, gain sharing and open book accounting. But only 15 per cent of authorities told us that they had the right to share in refinancing benefits. The Office of Government Commerce is preparing revised guidance (see paragraph 1.9) which is likely to recommend that contracts should give authorities approval rights over refinancings and contain provisions on sharing gains; and
 - although most PFI projects are still at an early stage, dealing with change is already a significant issue. Use had been made of change procedures in 55 per cent of the contracts which contained such procedures. These changes related to alterations in services covered by the original specification, the introduction of new services, additional building works or design changes and amendments to performance measurement arrangements. Using the experience of early PFI projects to get the initial procurement right may reduce the need for contract changes on future projects. But some contract changes may well still be necessary and authorities need to ensure that value for money will be maintained where these occur.

Having staff with the right skills is critical to good contract management

- 15** Even where the right contractual framework has been put in place, the authority may fail to realise the full potential benefits of the project if it does not manage the contract effectively. This requires a thorough understanding of the project and the contractual arrangements and an ability to build effective relationships with contractors.
- 16** Most authorities considered that the staff in their contract management teams had sufficient skills and experience. But authorities' responses to our survey suggested a considerable variation in the extent of training provided in contract management skills, with some authorities providing little or no training. As part of the training that is required, lessons from managing current projects need to be disseminated quickly. There are also difficulties in achieving staff continuity. Authority staff who have experience of PFI procurement may be transferred to other PFI procurement teams or they may find that their experience is marketable outside the public sector.



- 17 Authorities would welcome further guidance on managing relationships with contractors and have identified a number of areas where further guidance would be helpful. Contractors also believe that there should be further training for authorities. They have emphasised the need for authority staff to have greater commercial awareness, which could be achieved through specialised training or work placements with commercial organisations.

The partnership framework must be made to work in practice

- 18 A good partnership relationship is one where both sides are open, share information fully and work together to solve problems. It is not easy to secure this form of relationship and there are challenges to authorities and contractors in achieving this in PFI projects.
- 19 In our survey, two thirds of contractors thought their relationship with authorities worked in an open and trustworthy environment most or all of the time. But some projects had clearly suffered from a lack of openness or poor communications. Some projects had successfully co-located authority and contractor staff to improve communications and to identify and deal with problems more quickly.
- 20 The responses to our surveys showed the following experiences of how aspects of the relationship between authorities and contractors have been working in practice:

Governance arrangements - PFI contracts include a range of governance arrangements dealing with how performance will be monitored, problems resolved and new services or other changes dealt with. Most authorities and contractors considered that governance arrangements were working well.

Innovation - Although most contractors said their contracts had given them scope to be innovative, some contractors who had high expectations of prospects for innovation found they were less able to be innovative than they had initially anticipated. They attributed this to departments having fixed views on design features or other aspects of how the service should be provided. Most authorities considered their contractors had been partially innovative in taking projects forward.

Authorities' monitoring of contractors' performance - Authorities need to ensure that contractors are providing accurate and valid performance data. Three quarters of contractors thought authorities had adopted an appropriate approach to monitoring their performance. Some contractors, however, felt their relationship with the authority had suffered as a result of the authority becoming too closely involved in performance monitoring.

Reassessment and review of the relationship - Authorities and contractors need to review their relationships on a regular basis to establish how they can be improved and maintained. A number of authorities and contractors had done this, for example by holding an away day or other form of joint event.

Lessons for procurement and management of PFI projects are pertinent for other means of procurement

- 21 PFI has introduced changes in the way public services are procured and managed. For example, PFI contracts require clearly defined performance levels and financial penalties to be levied for failure to meet those defined performance levels. Authorities and contractors have devoted a great deal of



effort to create effective governance arrangements to manage their relationships. While the scope allowed for innovation has varied, the PFI method of procurement has shifted authorities' focus from the rigid specification of inputs to a concentration on critical outcomes.

- 22** Our recommendations for improving the management of PFI contracts are pertinent for other types of project. Departments and the Office of Government Commerce should, therefore, ensure that good practice developed under the impetus of PFI is also followed, where appropriate, in conventionally funded procurement and directly managed public services.
- 23** There is existing Treasury Taskforce guidance 'How to Manage the Delivery of Long Term PFI Contracts'. The Office of Government Commerce has also already issued best practice guidance called 'How Major Service Contracts Go Wrong'. This highlights how important it is to manage the relationship with service contractors and areas that might cause potential failure to occur. The Office of Government Commerce is also: considering commissioning the development of further contract management guidance based on its own feedback from departments, updating the standardisation of PFI contracts guidance and developing a PFI practitioner skills module to form part of the wider skills framework for government procurement. In addition, its Gateway review process will be used to monitor how contracts are being managed and to identify areas where guidance needs updating.

Recommendations

24 As a result of this examination we make the following recommendations:

- A Authorities and contractors should always seek to understand each other's businesses and establish a partnership approach to each of their PFI projects based on a common vision of how they will work together to achieve a mutually successful outcome to the project.
- B Authorities must give attention at an early stage in the procurement process of a PFI project to contract management issues and how their relationship with the selected PFI contractor will be developed.
- C Authorities need always to consider when developing a PFI contract the factors which may require changes to the contract after it has been let. The authorities' priorities may change or other factors may arise such as the opportunity to take advantage of improved technology. Appropriate contractual procedures for dealing with change should be built into the contract. The procedures need to ensure that value for money is maintained when contract changes occur.
- D During the procurement stage authorities must develop a staffing and training plan to ensure that they have staff with the right skills and experience to manage the contract after it has been let and to build a good working relationship with the contractor.
- E Authorities should regularly re-assess their relationships with contractors, and the value for money their projects are delivering, to identify ways in which relationships can be improved.
- F The Office of Government Commerce should take forward its plans to consider further guidance on contract management issues and should consider facilitating opportunities for staff from different authorities to share experiences of managing PFI contracts and relationships with PFI contractors.

We have set out in Appendix 3 points to be considered in taking forward these key recommendations.