National Audit Office

HM REVENUE & CUSTOMS

ASPIRE – the re-competition of outsourced IT services

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL | HC 938 Session 2005-2006 | 19 July 2006

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LONDON: The Stationery Office
£11.25

Ordered by the
House of Commons
to be printed on 17 July 2006

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

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26 June 2006

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EXECUTIVE SUMMARY

1 In January 2004 the Inland Revenue, now HM Revenue and Customs,[1] entered into a contract with Capgemini to provide IT services to support the Department's business. The strategic outsourcing contract, known as ASPIRE (Acquiring Strategic Partners for the Inland Revenue), replaced the Department's previous contracts with EDS for IT services and with Accenture for the National Insurance Recording System (NIRS2). The ASPIRE contract, which came into operation in July 2004, is worth between £3 billion and £4 billion over a ten year term, with an option to extend for up to eight more years. The Department embarked on the competition, having evaluated various options for providing its IT services including whether to extend the existing contracts. It concluded that its requirements could best be met by a strategic partnership with co-partnering with a single supplier having overall accountability for IT delivery.

2 ASPIRE is crucial for the Department in meeting its objectives. The Department serves 29.5 million taxpayers, around two million employers and one million companies, as well as 70 million accounts in the national insurance system. It employs 95,000 full time equivalent staff across around 600 offices and in 2005-06 collected almost £400 billion in receipts. The Department is responsible for collecting the bulk of tax revenue as well as paying tax credits, policing the national minimum wage, collecting student loan repayments as well as strengthening the UK's frontiers. During 2005, the Department's IT systems issued 16.5 million income tax self assessment statements, 1.4 million corporation tax notices to file, six million personal pension statements to employers and processed 9.7 million annual tax codings reviews.

3 This report examines how well HM Revenue and Customs handled the procurement and the subsequent transition to a new contract and supplier. It covers:

- **the procurement:** whether the Department took appropriate steps to choose the right option to meet its IT needs and get value for money (Part 1);
- **the transition:** the Department's management of the transition from one supplier to another (Part 2); and
- **initial performance:** the Department's management of ASPIRE and how the contract is dealing with changing requirements (Part 3).

4 Our study methodology is at Appendix 1. It included interviews with the main project team, bidders and suppliers; review of the contract and procurement documents and of the process used to test the financial model for the contract; comparisons of ASPIRE with other contracts in the UK and overseas; benchmarking of contract profit margins, and advisers' and procurement costs, and case examples of business-critical projects to examine the effects of changing supplier on projects spanning the transition. With effect from 1 April 2006 the Department extended the ASPIRE contract to include the services previously provided by Fujitsu under the former HM Customs and Excise IT PFI contract together with other former 'in-house' IT services. While this report refers to the change in the contract it does not evaluate the value for money of the revised contract.

1 Until April 2005, responsibility for ASPIRE was vested in the Inland Revenue. Under the Commissioners for Revenue and Customs Act 2005 HM Revenue and Customs assumed the functions previously vested in the Inland Revenue and HM Customs and Excise. In this report, references to HM Revenue and Customs, or the Department, cover both the functions of the Inland Revenue up to 18 April 2005 and the new HM Revenue and Customs.

Main conclusions

5 The Department was successful in completing the first major re-competition of a large public sector IT contract. As the Department's IT services had been already outsourced there was no public sector comparator available. It was concerned that potential competitors might perceive EDS to be a strong incumbent that could not be easily displaced. But the Department secured competition for the £3 billion ASPIRE contract which meets its IT needs, and completed the transfer from one supplier to another without a loss in service to the Department's customers.

6 It is the usual practice when purchasing goods and services for the bidders to meet their own costs and to pay the costs involved in taking over the position from the previous supplier. It is not usual practice for the purchaser to create the competition by contributing to firms' costs of bidding, paying the winner's costs in taking over from the existing supplier, discounting the transition costs for the purposes of comparing bids and paying the incumbent supplier to effect the transfer. The payment of such costs is not unknown, and the Committee of Public Accounts outlined the circumstances in which this could be advantageous namely to avoid such costs being incorporated, with a mark up, in higher charges, and to encourage bids.[2] In the case of ASPIRE the premium paid by the Department to secure a competition was £8.6 million in contributions to bidding costs, and £43.3 million in paying for contractors' transition costs.

7 There was justification in this case for using incentives to encourage competition. The Department's reasons for paying this premium and discounting it when evaluating the bids were to secure a competition to get the best results. It ruled out the possibility of renegotiating the existing contracts, after taking legal advice which indicated it would risk legal challenge from the incumbents' competitors. The Department also considered that not to pay these costs would send out a wider signal to the market that the Department was effectively locked-in to the incumbent supplier because the costs of transition would make the competition unwinnable for any supplier other than the incumbent.

8 Contributing to bidders' costs and the costs of transition to encourage and maintain sufficient competition during the procurement was an essential step to achieving value for money in this deal. Compared to the total value of the ASPIRE contract the costs of procurement and transition totalling £75 million were small – some two per cent of the projected value of the contract. The Department estimated that transition costs would be in the range of £30 million to £50 million. The actual transition costs were £37.6 million paid to Capgemini and £5.7 million paid to EDS and Accenture as the incumbent suppliers. There remains a question whether the Department needed to pay this much. Although the Department was in new territory, it might have obtained better value for money from this spending by maximising the benefits from its contribution to the cost of bidders' design and implementation studies and from tighter control over the transition costs. The actual transition costs were negotiated after the contract was awarded and included a profit margin of 15.5 per cent for Capgemini. One lesson is to negotiate the terms on which transition costs are to be paid while the procurement is still underway to benefit from the competitive tension. The Department also incurred an extra £2 million on the delayed transition of NIRS2 which did not run according to plan. Further lessons are to secure the intellectual property rights to use the IT system after the contract ends and require the incumbent supplier to share information with bidders, and to ensure the contractor bears its own cost overruns.

9 The new supplier has provided IT services from day one of the contract, meeting or exceeding target service levels. Since transition there have been some delays on projects, attributable mainly to changes in the Department's requirements. For ongoing projects the Department agreed cost, time and delivery outputs which were more cautious than those agreed under the previous contract, and for 18 months the new supplier was paid for ongoing projects on the delivery terms of the previous contract which stipulated payment on the basis of resources used but using the costs agreed under the new contract. The payment terms of the new contract are linked more closely to project delivery than under the previous contract, and these are being applied to new projects.

2 Committee of Public Accounts Report, *London Underground Public Private Partnerships*, HC446, March 2005.

10 There have also been significant cost increases due to the Department's increased demand for IT services and projects which was higher than it anticipated at the time the procurement was run. The actual profits made by the supplier have also been higher than expected when the Department awarded the contract because of the higher volume of work and large number of IT projects in development but the overall target profit margin has not been exceeded. The contract prices include profit margins in line with industry margins, with lower margins for lower value-added service lines and higher margins in the riskier project area. The contract includes a provision for prices to increase annually with the Retail Price Index and annual reductions for efficiency improvements. Prices can be varied for events outside the contractor's control and there are penalties for underperformance. Prices can and have been renegotiated up and down where volumes change. If the overall target profit margin of 12.3 per cent is exceeded, the Department can obtain an equal share of the extra profits.

11 The overall value for money of this contract, and the premium the Department paid to secure it, will ultimately depend on how well it meets the Department's IT needs over the lifetime of the contract, including how well it deals with the degree of change in taxes and other services and the Department's systems and organisation. It will also depend on how well the Department controls costs and manages performance to ensure the benefits of the contract are achieved. The Department does not have an estimate of the final costs of ASPIRE because it is difficult to predict the level of IT demand, price changes and changes to the Department's activities over the lifetime of the contract. It has yet to evaluate the new supplier's overall performance. The business change and innovation aspects of the ASPIRE contract have assumed greater importance with the creation of HM Revenue and Customs in April 2005, and the increased levels of work which have placed greater pressure on the Department and Capgemini's capacity to deliver. The Department will need to continue to review resourcing priorities with Capgemini so as to maintain ongoing services as well as delivering change programmes, and ensure it has robust arrangements for managing the contract so that it delivers the best performance from the contractor.

Wider lessons

12 Across government there are around 540 Private Finance Initiative (PFI) contracts with a total capital value of almost £40 billion[3] and other IT outsourcing contracts. As these contracts reach the end of their first-term, departments are likely to face similar competition and transition issues to those HM Revenue and Customs has encountered.

13 ASPIRE provides lessons on preparing for the end of a contract and encouraging competition, and for managing the transition from one supplier to another and in providing sufficient flexibility within a contract to deal with likely changes in IT requirements. Good practice to help departments in re-competing their IT contracts and managing transitions (Part 4 of this Report) should result in financial savings from better contracts, and reduce transition costs and the risk of service disruption. Implementation of this including the good practice which the Department developed and adopted is likely to save at least 10 per cent of the costs of procurement and transition and our recommendations are aimed at departments doing that in similar situations.

14 Now that the public sector has demonstrated it is not locked into retaining well established incumbent suppliers for contracts of this size, there is a need for the Office of Government Commerce to provide guidance on:

- the contract provisions needed to deal with the end of a contract and securing the best prospect of effective competition at that time;
- the use of incentives to stimulate competition; and
- managing the transition to a new supplier.

15 The changes required for the merger of the Inland Revenue with HM Customs and Excise so early in the life of the ASPIRE contract suggest the need for a mechanism by which government IT contracts can be looked at as a whole, as the decisions made by one department can affect others. Such horizon-scanning would ensure that IT contracts across government are managed effectively: examining overarching issues of competition, supplier capacity, exit arrangements and transition planning. This would enable departments to have meaningful discussions about contract strategies and timings rather than pursuing purely independent strategies. The lesson for government departments is that even with that central oversight, they need to build into their contracts a sufficient level of flexibility to deal with machinery of government changes.

3 HM Treasury PFI signed project list.

Key facts, findings and conclusions

16 The Department estimated extending the existing contracts would cost £4.1 billion compared with £3.8 billion for the chosen solution (a strategic partnership with co-partnering with a single supplier having overall accountability for IT delivery). Once that option had been selected the Department went out to competition and developed its IT requirements which included further changes in requirements and changes in contractual volumes. The RPS bid (EDS/Accenture) was within 1 percent of the Capgemini bid at £2.83 billion. The costs incurred by HM Revenue and Customs during procurement (£27.5 million), transition (£47.5 million) and in the first year of the ASPIRE contract (£539.3 million) are set out in **Figure 1** opposite. Compared to the contract it replaced, the new supplier is paid on the basis of performance achieved (outputs) rather than resources used (inputs). ASPIRE also has incentives for improved efficiency over the lifetime of the contract and greater flexibility for the Department to decide the most desirable point for re-competition.

The Procurement

17 To secure competition and to choose an option to meet its IT needs, the Department:

- Followed Office of Government Commerce guidance, drew on lessons from the previous contracts which ASPIRE replaced and followed the recommendations from the Committee of Public Accounts' previous report on the Inland Revenue/EDS strategic partnership.[4]
- Drew on the experience of the London Underground PPP that in some cases departments may not be able to develop sufficient competition without reimbursing bid costs.[5]
- Evaluated eight contracting options and selected a strategic partnership with co-partnering, where a single supplier has overall responsibility and accountability for IT integration and the Department has access to a range of suppliers and new technology so it is not locked into one or two large suppliers.
- Consulted the market early, fostered competition by persuading senior management in the IT industry to bid for the contract and convinced bidders that it intended to seek genuine competition.
- Encouraged competition by partially paying bid costs (£7.7 million for work to allow bidders to demonstrate their IT capabilities), paying for the 'unique' costs of transition (£37.6 million) and excluding the costs of transition from the bid evaluation.
- Maintained competitive tension until the final contract award by negotiating with two bidders until the end of competition, aided by agreeing to contribute towards the costs of the losing bidder (£0.9 million).

18 The Capgemini bid best met the Department's IT needs. The eventual value for money of ASPIRE will also depend on how far the Department can control additional costs arising from changes to the contract. It will also depend on how well investment in individual projects and the programme as a whole supports its change programme for integration, improving efficiency and achieving its Public Service Agreement targets.[6, 7] The detailed results were:

- Capgemini's bid (£2,830 million) was £32 million higher than that (£2,798 million) of the other final bidder, RPS (EDS in alliance with Accenture). But Capgemini's bid better met the Department's IT needs to support its change programme and implement business transformation. It was around 21 per cent lower (£816 million) than the Department's Should Cost Model had indicated. That Model included some efficiencies over the life of the contract but both bidders were more aggressive in their forecasts of efficiencies.
- The Department assessed the value for money of the bids on the basis of a combination of financial and qualitative analysis of potential suppliers to provide the IT flexibility required to support ongoing IT applications and to implement business transformation.

4 Inland Revenue/EDS Strategic Partnership: *The Award of New Work* (28th Report 1999-2000).
5 C&AG's report on London Underground *PPP: were they good deals*, HC 645, June 2004.
6 *Financing Britain's Future – Review of the Revenue Departments*, Gus O'Donnell, March 2004, HM Treasury Cm 6163.
7 *Releasing resources to the front line – Independent Review of Public Sector Efficiency*, Sir Peter Gershon July 2004.

1 ASPIRE costs

Stage	Costs (£ million)	Comment
Procurement		
Procurement advisers and commercial lawyers	9.5	
Contribution to Design and Implementation Studies and tender costs	7.7	The Department capped its contribution to the Design and Implementation Studies for each bidder.
Departmental staff and running costs	9.4	18,000 staff days were charged. Also includes £3.1 million for IT support for Design and Implementation studies.
Due diligence	0.9	The Department capped these costs at £3.3 million for each bidder. £0.9 million was paid to EDS, who as the incumbent had less due diligence. Had Capgemini lost the competition it would have charged £3.3 million.
Total	**27.5**	
Transition		
Unique Transition Costs	37.6	Paid to Capgemini. EDS estimated Unique Transition Costs (UTCs) at £4.4 million if it had won the contract. (£3.4 million of UTCs paid to Capgemini/Fujitsu for NIRS2 transition is included in the £37.6 million).
Costs paid to the Incumbent suppliers for supporting the transition	5.7	£2.3 million to EDS (support during the transition) and £3.4 million to Accenture for support during transition and the re-platforming of NIRS2.
Departmental staff and running costs	1.3	6,800 staff days were charged.
Consultants	2.4	
Department of Work and Pensions staff and IT support costs	0.5	
Total	**47.5**	
Contract year 1		
Service lines	298	
Project lines	244	
Service credits in respect of services	(2.67)	This related to 8 IT system failures in the first contract year. There were 10 failures costing £3.25m in the first 15 months.
Total	**539.3**	

Source: National Audit Office analysis of the costs incurred by HM Revenue and Customs from the different stages of ASPIRE, up to the end of the first contract year

NOTES

1 Costs in £ million including the VAT which is irrecoverable to the Department.

2 In preparing for the transfer, the Department also incurred £14 million for the rights to use NIRS2 after the termination of the contract although the intellectual property rights remained with Accenture. This represented a closing payment as part of the 1995 PFI contract.

- An Office of Government Commerce review concluded that the Department had run the competition to a high standard and had maintained an effective competition.
- The Department managed the procurement at a cost of £27.5 million, including £6.3 million for staff and running costs, £9.5 million for advisers and £7.7 million for bidders to assist them to demonstrate their IT capabilities and £3.1 million to provide infrastructural support to that exercise. This compares favourably with the procurement costs on PFI contracts.
- The contract includes service line thresholds so that if there is a significant change in demand for IT services beyond the thresholds, the Department can negotiate price changes.

The transition

19 While the contract will only achieve value for money in the longer-term if the new supplier delivers a good service and progresses IT projects as planned, it was important for the Department to manage the risks of transition. These were that services would be disrupted, individual project deadlines missed, the incoming supplier (Capgemini) not ready to run the service and carry out business-critical projects and that the costs of transition would be higher than expected.

The costs of transition

20 The transition cost the Department £47.5 million, including £37.6 million paid to the incoming supplier for its 'unique' transition costs and £5.7 million to EDS and Accenture over and above normal running costs to facilitate the transition.

- The payment of transition costs was justified because it encouraged and maintained competition. These costs would have been very much lower had the existing suppliers continued to provide the IT service.
- The Department reviewed Capgemini's financial estimates for 'unique' transition costs. While the Department laid out the principles for qualification as a unique transition cost and controlled individual transition costs within the budgets set, it had not agreed in advance with Capgemini the detail of what would qualify as a 'unique' transition cost until the transition had started. It considered it could not have anticipated all the elements to include at that stage. This resulted in both parties spending valuable time during transition negotiating whether or not a particular cost was unique. The Department also paid Capgemini a profit margin on the staff costs involved.

Maintaining service during transition

21 During the transition there were no major disruptions to services and the incumbent suppliers' performance remained steady.

- The main transition was completed according to schedule in six months. Keeping ongoing projects on track was a major part of the transition.
- There were nearly 100 of these projects valued at £439 million in development, including several 'mission-critical' projects with tight deadlines such as the Modernising PAYE Processes for Customers, the introduction of the Child Trust Fund, Reform of the Construction Industry Scheme, and Modernising Stamp Duty.
- The transition was helped by the professional working relationship of EDS and Capgemini and the collaborative partnership relationships that the Department fostered. This was supported by the exit clauses the Department had negotiated in the previous contracts which bound EDS to levels of support, assistance and delivery during the transition. EDS also agreed to fund the £65 million pension shortfall of the staff transferring from the previous contract.
- By June 2004 Capgemini had taken over 97 per cent of third-party contracts used by EDS and around 96 per cent of EDS staff, including 80 per cent of the key staff identified, and had filled many of the vacancies of EDS staff leaving at the end of the contract.

National Insurance Recording System (NIRS2) transition

22 The NIRS2 transition was run as a separate project from the main transition with a budget of £16.2 million and involved the transfer of IT data systems from Accenture. This proved more difficult than expected, took longer than planned and cost the Department £3.4 million paid to Accenture to support the transition and £3.4 million paid to Capgemini for transition costs. Accenture were retained by Capgemini as a sub-contractor.

- Under ASPIRE, the Capgemini and Fujitsu consortium took over responsibility for the running of NIRS2 from Accenture in January 2005 which included the re-platforming of the IT system.
- Delays occurred in re-platforming NIRS2 because: Capgemini's transition plans proved to be ambitious given its level of expertise in the design and operation of the system; the structure of the PFI deal with Accenture meant that the degree of collaboration between Accenture and the incoming supplier was initially not as strong as in the main transition, and Accenture's workforce was less willing to transfer to the new supplier.
- The nature of the PFI contract with Accenture meant that the Department had to agree with Accenture exit procedures to disclose key information during due diligence to assist the incoming supplier and the Department had limited in-house knowledge of the IT used in NIRS2. The Department for Work and Pensions also incurred £0.5 million staff and IT costs for the NIRS2 transition. Accenture met its obligations under the agreed exit provisions.
- Capgemini/Fujitsu encountered problems in its first attempt at providing the new IT hardware, operating system and database to support NIRS2. The Department requested changes to Capgemini's plans. Capgemini retained Accenture as a sub-contractor under ASPIRE and rescheduled the work in phases which was completed in September 2005.
- The cost of completing the migration in the deferred timescale was £9.9 million, of which Capgemini/Fujitsu paid for £7.9 million and the Department £2 million. The total costs to the Department to complete re-platforming were £14.9 million. This was within its original estimate of £16.2 million so the Department decided that it was not worthwhile establishing all the causes of failure and attribute them to any party, although it did not accept liability for the costs of any consequential reworking. Although the delays did not affect service delivery, the system was not fully operational until November 2005 and since then the system has performed at improved levels.

Management of the contract

23 An initial view of how the contract is performing was assessed from the performance of the supplier in delivering IT services and progressing the main IT projects supporting the Department's business and change programme, the cost of ASPIRE and the degree to which the Department is acting as an intelligent customer of IT services.

Provision of IT services and delivery of IT projects

24 The new supplier has provided IT services from day one of the contract but since transition there have been some delays and cost increases.

- The performance of IT services is acceptable, although there have been some isolated system failures for which the supplier has paid £2.67 million in penalties in the first contract year.
- Although the new supplier has delivered a number of IT system releases, there have been some delays and cost increases to business-critical projects (for example the Construction Industry Scheme, the Modernisation of PAYE Processes (MPPC), Better Data for corporation tax, on-line services and the External Routing Interface Component for electronic returns by employers). The delays and cost increases are mainly due to the Department changing its requirements and due to the inclusion in project costs of overhead rates previously budgeted for centrally.

ASPIRE Costs

25 The ASPIRE contract has cost more in the first year than the Department originally planned because the Department had increased the volume of work that it required from ASPIRE.

- The Department estimated it would spend £383.8 million (excluding VAT) in the first year of the contract. This was based on the demand for IT services in 2002-03 which was used in the invitation to tender. The expenditure in the first year from July 2004 to June 2005 was £539.3 million (and the Department forecasts expenditure in the second year to be around £800 million).
- The increase in spending on ASPIRE has been due mainly to the 132 per cent rise in spending on projects (an increase of £98 million) and consultancy (an increase of £27 million). The retention of Accenture to provide application development support for NIRS2 has cost £3.24 million in the first year of the contract and is estimated to cost £8.04 million over three years.
- The Department considered that bidders might be deterred by the prospect of taking on nearly 100 existing projects, valued at £439 million, with outputs and timetables they had not planned, so it paid the new supplier for ongoing projects on the terms of the old contract. While this may have helped maintain competition by persuading bidders that a new supplier would not be bound by the existing project delivery plans, it meant for the initial period of the contract, the Department could not benefit from the delivery benefits of the new contract which pays on the basis of performance achieved rather than resources used.

Acting as an intelligent customer

26 The increase in the cost of ASPIRE emphasises the importance of the Department being able to control costs and to ensure value for money from the additional spending. This includes triggers to review the supplier's profit margins to ensure that the Department gets a share of any additional efficiency savings from increased levels of work.

- The Department's higher than expected demand for IT has arisen mainly from the project work involved in developing and enhancing IT systems and significant changes to the Departmental infrastructure.
- The higher than expected demand for IT has generated a higher profit for Capgemini in the first year, likely to be £53.9 million[8] (10 per cent profit margin) compared to the projected profit of £38 million (also with a 10 percent profit margin). The target profit margin was based on 2002-03 levels of IT demand and is around 12.3 per cent which is within the range of PFI deals of between 10 to 17 per cent. As the projected profit margin is lower than the target profit margin, it is unlikely that any profit share will accrue to the Department for the first year.
- If this level of higher spending continues at the same level over the lifetime of the contract, the final cost of the ASPIRE contract could be in excess of £6 billion rather than the originally projected £3-4 billion. But the Department does not expect this level of internal demand for IT services to be sustained. It considers its demand for IT services will decline because of its targets for reducing staff levels by 12,500, an increase in the use of electronic services with a reduction in keyed input and printed outputs, proposals to rationalise IT systems, and its aim to reduce spending on IT to less than 20 per cent of the Department's budget.

8 Based on provisional figures.

- The need to control costs is reinforced by the growth in the Department's demand for IT services under the previous contract which led to increased charges. When the Department awarded the previous contract in 1994 it was valued at £1 billion (which excluded price indexation or growth). By 2000 the Department estimated that it would cost £2 billion taking account of price increases and demand for IT services and the final spending under the contract was £2.5 billion due to the increase in its demand for IT services.
- As the Department's volume of demand for individual IT services increases beyond agreed caps it will obtain discounts on unit price based on economies of scale. However price increases are also possible where the supplier has been unable to avoid extra costs. Some of the thresholds have been exceeded in the first year and the Department has negotiated price changes with Capgemini which resulted in a minor price increase and three significant price reductions.

27 The Department is changing the way it manages the new IT contract which is more focused towards service delivery and productivity. The Department:

- is reviewing the number and kind of performance measures it uses to monitor the contract to identify gaps and improvements and to align measures to business targets and outcomes. There are over 500 performance measures, of which some 200 are key performance indicators and carry service credits for underperformance;
- has recognised that its staff need a better understanding of the new contract and has provided training for staff on how the new contract operates;
- is seeking to reduce the ratio of staff it uses to manage the contract compared to the supplier's staff from 30:70 to 20:80; and
- is collecting information to evaluate the performance of the supplier such as: monitoring progress made on major projects, evaluating performance against a range of targets and reviewing financial statements showing the actual costs and the supplier's profit margin. However it recognises that this needs to be improved to reflect the new contract. The Department has taken 18 months to get an overall view of how the contract is performing and to put into effect the arrangements for managing the contract.

Contract flexibility

28 With effect from 1 April 2006 the Department brought those services previously provided to the former HM Customs and Excise by Fujitsu under the PFI contract into the ASPIRE contract. ASPIRE is now the main contract for the provision of IT services to HM Revenue and Customs.

- When the former HM Customs and Excise renegotiated its PFI contract with Fujitsu in 2003, it considered that its IT infrastructure could be connected to that of the Inland Revenue at no significant additional cost.
- The Department considers that in merging the PFI contract with Fujitsu into the ASPIRE contract the changed contract should provide a lower cost of delivery than having two separate contracts over the lifetime of the ASPIRE contract.

RECOMMENDATIONS

29 The specific recommendations for HM Revenue and Customs which the Department is putting into action are that it should:

a **ensure it has effective governance and performance management systems** which provide a clear view of the contractor's overall performance and inform any negotiations on contract changes.

b **update and rationalise by early 2007 the ASPIRE contract Key Performance Indicators so that they are better aligned to the business of the new Department, focus on the main areas of supplier performance and are output-orientated.**

c **extend the education programme during 2006 to ensure that all key staff in the Department's business areas are trained in how to carry out output-based contract management.**

d **review the priority of its existing projects so that they match the capacity of its own staff and IT suppliers to deliver them** and make progress payments on all projects on the basis of outputs/ outcomes achieved rather than resources used by the supplier.

e **review the expected cost of ASPIRE over the lifetime of the contract using sensitivity analysis to take account of trends in the demand for IT services, price changes and the inclusion of the PFI contract with Fujitsu and monitor the efficiency savings delivered.**

f **ensure the Department has in place robust programme and project management arrangements so that it can extract the best supplier performance from the ASPIRE contract.**

Wider Recommendations

g **Other government departments should learn the lessons from ASPIRE outlined in Part 4 of this report.** To support this, the Office of Government Commerce (OGC), will be working with the National Audit Office and HM Revenue and Customs to produce guidance on lessons learnt from the ASPIRE exercise. Any guidance should cover:

- **the need for departments to review existing contracts** to ensure that they have the necessary provisions to deal with the end of the contract and for managing a transition to a new supplier if the incumbent is not retained;
- **the contract arrangements for initial outsourcing deals that give the best prospect of achieving effective competition when the contract comes to an end;**




- **the use of incentives to encourage other suppliers to compete including the circumstances in which contributions to bidding and transitions costs might be made, and alternatives where they provide better value for money,** for example:
  - solely disregarding transition costs in the evaluations of bids;
  - disregarding transition costs in the bid evaluation and paying a share of transition costs; and
  - disregarding transition costs in the bid evaluation and negotiating a capped budget for transition costs.
  - If transition costs are paid they should be negotiated as part of the deal to maintain competitive tension and the contract should include a trigger which requires the supplier to repay some part of the transition costs where first year profits are higher than expected.
- **the options, use and cost-effectiveness of methods to test bidders' capabilities when there is a well established incumbent supplier.**

h **The Office of Government Commerce should take the lead in coordinating a centralised process to review the number and timing of large government IT contracts which are nearing the end of their term so that re-competitions can be scheduled in a way that stimulates effective competition for each.** The process should involve representatives from departmental procurement and IT strategy teams across government.

PART ONE
The procurement

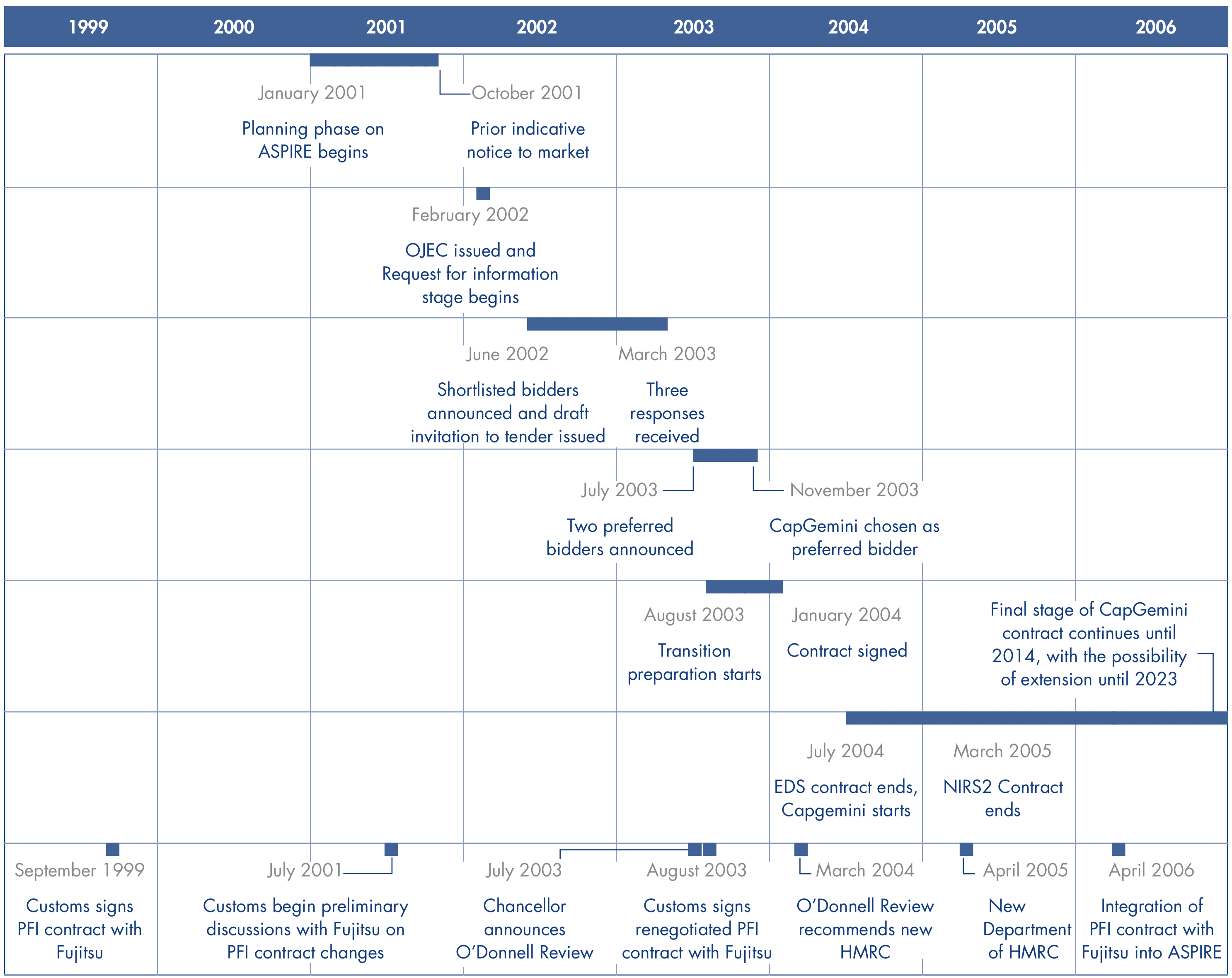
This part of the report examines the Department's replacement of its existing £2.5 billion contract with EDS and £200 million contract with Accenture for the provision of IT services, why a new contract was needed and how the Department prepared for the new contract. It covers the steps the Department took to achieve effective competition, and whether in doing so it followed relevant Office of Government Commerce guidance and drew on the lessons learned from the previous contracts which ASPIRE (Acquiring Strategic Partners for the Inland Revenue) replaced. It also looks at the criteria the Department used to assess the value for money of the bids and the procurement costs.

The need for new IT contracts

1.1 In 2004-05 the Department needed to replace its IT contracts that support its business. It had two main IT suppliers – EDS providing technology services for tax activities and the development of new systems under a £2.5 billion 10 year contract ('Eagle') due to end in June 2004[9] and Accenture supporting National Insurance operations through the National Insurance Recording System (NIRS2) under a £200 million 10 year PFI contract due to end in March 2005[10] **(Figure 2 overleaf)**. A new contract would need to provide the IT flexibility for the Department to respond to recommendations from the O'Donnell Review of Revenue Departments[11] and the Gershon Efficiency Review[12]. The merger of the Inland Revenue and HM Customs and Excise in 2005 increased the need for IT to support the new Department's change programme.

9 The spend under the Eagle contract was £2.517 billion.
10 The spend under the NIRS 2 contract since April 1999 when the former Contributions Agency merged with the former Inland Revenue was £250 million.
11 *Financing Britain's Future – Review of the Revenue Departments*, Gus O'Donnell, March 2004.
12 *Releasing Resources to the Front Line – Independent Review of Public Sector Efficiency*, Sir Peter Gershon, July 2004.

2 ASPIRE timeline



Source: National Audit Office

Preparing for a new contract

1.2 The Department's lawyers advised that an extension to the Eagle contract could be challenged by the incumbents' competitors. The contract contained an optional six month extension to provide contingency against any re-competition overrunning but, aside from this, the Department's IT arrangements would end abruptly. European Union competition rules required the Department to undertake an open competition. It therefore had to manage certain risks by:

- **Choosing an appropriate option to replace the EDS and NIRS2 contracts** – the Department appraised eight options and concluded it should let a single contract (rather than, for example, a series of smaller contracts). The contract is based around a single lead partner, responsible for service provision through permanent sub-contractors and co-partners.
- **Ensuring genuine competition** – to avoid the impression that EDS and Accenture had an unfair advantage and encourage new suppliers to bid for the contract the Department adopted a high-profile campaign to encourage major IT suppliers to bid for the contract. The IT industry needed persuading that there would be a level playing field for new suppliers. The Department addressed some of the perceived barriers to competition by funding transition costs, partly funding the costs of due diligence, providing access to key business sites and allowing suppliers to showcase innovation capabilities.
- **Finalising a contract on time** – the Department had built in contingency measures with the existing contract requiring EDS to maintain services up to the point of expiry or termination, co-operate with the Department and any successor supplier to ensure smooth continuation of services. It also went through the Office of Government Commerce gateway review process.

1.3 The main challenge for the Department was to achieve an effective competition. It was concerned that potential competitors might perceive EDS to be a strong incumbent that could not be easily displaced. This could result in insufficient bidders to ensure that the new contract would fully provide for the Department's IT needs.[13] The Department also considered that not to pay transition costs would send out a wider signal to the market that the Department was effectively locked-in to the incumbent supplier because the cost of transition would make the competition unwinnable for any other supplier than the incumbent.

Contracting options

1.4 The Department considered eight options to replace the existing contracts, taking account of the future needs of the business, ranging from separate contracts split by service area to continuing with and developing the strategic partnership approach it had pursued under the Eagle contract **(Figure 3)**.

3 The Department's short-listed contracting options

	Option	Cost of option (10 year net present value) (£m)	(Saving)/Extra cost compared to do-minimum (£m)
1	Do-minimum (extension of current EDS and NIRS2 contracts)	4,134	n/a
2	Strategic partnership with co-partnering	3,846	(288)
3	Separate contracts split by service areas	4,194	60
4	Separate contracts with different suppliers	4,286	152

Source: National Audit Office analysis of HM Revenue and Customs data

NOTES

The Department also considered other options which it did not financially assess:

Option 5: Strategic co-partnering and transfer of desktop assets – similar to Option 2 but including desktop assets and – more significantly – in the accounting treatment afforded to the ASPIRE assets as a whole.

Option 6: Package by business stream – would result in one large contract package covering the core tax systems, very much like Option 2, and a range of smaller packages covering business streams. It would be sub-optimal to Option 2.

Option 7: Including business process outsourcing – differs by including all Inland Revenue business processes. This would have required a more extensive appraisal as the options only examined the future provision of IT services.

Option 8: Extend to wider government – differs by extending from the Department to other government departments. This option was kept open by referring to the possibility in the initial advertisement placed in the Official Journal of the European Community; and including standard enabling clauses in the resulting contracts.

13 The risk of not getting sufficient competition with an incumbent supplier is also covered in the NAO Report on *Awarding the new licence to run the National Lottery*, HC 803, 2001-02, in May 2002.

1.5 In 2003, the Treasury decided against using PFI for IT projects, one reason being that the fast pace of change in the IT sector made it difficult to define requirements over a long-term contract.[14] The Office of Government Commerce subsequently issued guidance that projects focused on innovation would have a better chance of success using multiple contracts with the contract price based on the resources used by the supplier; projects with more stable technology would be more suited to longer-term contracts with the contract price based on the performance of the supplier in producing successful IT projects.[15] The Department decided that the range, scale and complexity of its IT requirement could best be provided by a strategic partnership with co-partnering. This option built on its existing single-supplier partnership approach under the Eagle contract with EDS, providing a single supplier with overall accountability for IT delivery. It also brought the additional flexibility and access to a wider range of suppliers - 'multi-sourcing' - so that the Department could use whichever co-partner would be best able to meet its IT requirement, recognising that no one supplier would have all the skills or the capacity to meet varying requirements.

Encouraging competition

1.6 The Committee of Public Accounts reports on the Inland Revenue/EDS Strategic Partnership[16] and the NIRS2 Contract Extension[17] concluded that it could be difficult to create effective competition for a large contract with a strong incumbent supplier. The Department began to develop its strategy for dealing with the end of the Eagle contract with EDS in 1998, six years before the contract was due to end. It initially found little interest from other IT contractors in bidding as they saw limited chance of success against a well established incumbent supplier. The Department's senior management engaged with the IT supplier industry to promote interest in bidding for the contract with the commitment that the competition would be open and fair and that all bidders would be operating on a 'level playing field'.

1.7 To demonstrate its commitment to and convince bidders it was worth the investment in bidding, the Department offered to pay the transition costs that only a new supplier would have to incur. Alternative suppliers had expected that they would have to demonstrate superior capability to the incumbents in order to compensate for greater transition risk and their bids would have to cover the costs of transition. The announcement that the costs of transition would not be included in the bid evaluation was an important factor in Capgemini's decision to bid. The commitment to a change and innovation programme was also important as it gave a strong indication that ASPIRE was a new contract, not just a continuation of the previous contract. A formal notice was placed in the Official Journal of the European Union (OJEU) in February 2002 to which four bidders responded. The Department short-listed three potential bidders for the next stage of procurement – RPS Alliance (EDS & Accenture – the incumbent suppliers), Capgemini with Fujitsu, and Fusion Alliance (BT, Computer Sciences Corporation, and Schlumberger Sema).

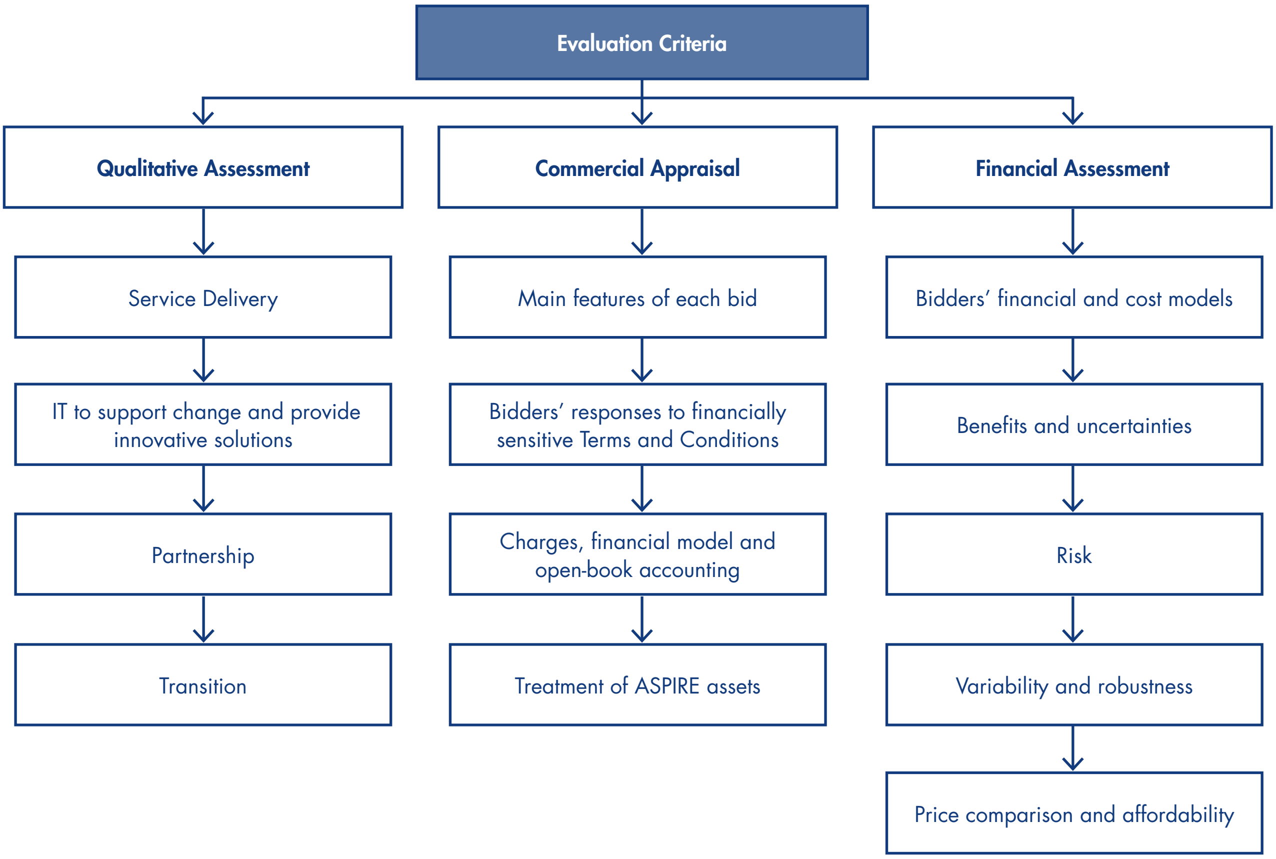
Bid evaluation

1.8 The Department evaluated the three bids against a range of criteria **(Figure 4)** including costs, client site visits, and qualitative assessments to see how well the bidders performed against Departmental objectives such as working in partnership and managing the transition.

1.9 The new bidders were concerned that the Department was aware of EDS's capabilities because it had worked with them, while it had no way of assessing the capabilities of the other bidders. To help to level the playing field, the Department provided the bidders with an opportunity to demonstrate their capabilities, using Design and Implementation studies to test bidders' capabilities. This also helped its own business areas to get used to the new way of working under the ASPIRE contract, with more emphasis on the Department getting the specifications right upfront. The studies cost the Department around £10.8 million, including £3.1 million to support the work and a £7.7 million contribution to the bidders' costs. The output from these studies was incorporated into the qualitative evaluation of the bids, but HMRC also retained the intellectual property rights from the studies in the proposals. Partial payment of bid costs was also partly justified by the outputs which could be used by the business. The Department has not formally evaluated these benefits and has not directly utilised the outputs from these studies but working on the studies did provide the opportunity for key departmental staff to gain experience in new working methods and to build specialist supplier relationships.

14 PFI: Meeting the investment challenge, HM Treasury, July 2003.
15 Decision map for project strategy and procurement, Office of Government Commerce.
16 Inland Revenue/EDS Strategic Partnership: The Award of New Work (28th report 1999-2000).
17 NIRS2 Contract Extension (38th report 2001-2002).

4 Evaluation criteria



Source: National Audit Office

1.10 The Department used financial models to evaluate the bids. It created an estimate of the likely costs as a benchmark - the Should Cost model – to compare the bids and assess productivity gains from the new contract and for the Department to challenge the bidder's financial models. The Should Cost model represented 'best in market' costs of meeting the existing IT needs, not taking account of potential performance improvements open to a new supplier. The Should Cost model included some efficiencies over the life of the contract, such as some productivity improvement but the bidders were more aggressive in their forecast of efficiencies. As part of the evaluation it carried out sensitivity analyses on the most significant service lines in the short-listed bidders' financial models.

1.11 We commissioned PricewaterhouseCoopers to examine the processes used to test bids against the Should Cost model. This found that the Department's financial evaluation was robust and comprehensive, although the Should Cost model could have been more flexible to enable improved value for money analysis. For example, by forecasting affordability over the whole ten year life of the contract, rather than just the initial three years, and to build in sensitivities, such as the ability to adjust for different discount, inflation or taxation rates over the contract life. Sensitivity analysis could also look at the effects of significant changes in the scale of work on affordability and supplier's profit margins. Given the size of the contract, changes to these variables during the term of the contract could have significant financial impact. The Department also used a 'Does Cost model' to provide an affordability benchmark for the three year Public Expenditure cycle based on the costs for the contracted out service levels at the prevailing EDS and NIRS2 rates.

1.12 The qualitative, financial and commercial evaluations were combined to provide an assessment of the most 'economically advantageous' tender. On 15 July 2003, the Department announced it would be taking forward the bids of Capgemini and RPS Alliance. It then carried out further assurance and negotiation; testing proposed solutions, carrying out due diligence work to address the risk of price changes once the contract had been signed, and analysis of the information provided in the bidders' financial models.

1.13 The Department agreed to contribute up to £3.4 million towards the costs of due diligence for the losing bidder in recognition that the quality of the due diligence conducted by the bidder was important to the Department's confidence in the bidder's solution and that this would be a more onerous process for the non-incumbents. This was to counter any concern that an alternative supplier was being retained simply as a lever for the Department to use in negotiations with the incumbent. The Department paid £0.9 million to the losing bidder (RPS) who did not have to perform as much due diligence work as a new supplier.

1.14 The final offer from Capgemini was £2,830 million and from RPS £2,798 million **(Figure 5)**. Although Capgemini's bid was marginally higher, the Department concluded that it was a considerably better technical offer and more likely to achieve the business objectives of the Department. The Should Cost Model and the bids changed during the negotiations due to changes in the Department's requirements, changes in contractual volumes, additional third-party contracts and an increase in the Department's asset base. Capgemini's bid had higher profit margins for project-related work than for the operational services and project demand might grow given the Department's programme of business change and innovation. The Department will update the Should Cost Model annually to reflect the relevant contract changes and actual service volumes ordered in the year to calculate the savings achieved.

The ASPIRE contract

1.15 In January 2004 the Inland Revenue (now HM Revenue and Customs) entered into a strategic outsourcing contract with Capgemini Ernst & Young (now Capgemini). The contract known as ASPIRE (Acquiring Strategic Partners for the Inland Revenue) came into operation in July 2004, is estimated to be worth between £3 billion to £4 billion (excluding VAT and inflation) over its ten year term and has an option to extend for up to eight more years. Changing suppliers sent out an important signal across government and the market that departments are not locked into incumbent suppliers, and should encourage competition for other second-generation IT outsourcing contracts.

1.16 Under the ASPIRE contract the supplier is paid on the basis of performance achieved (outputs) rather than resources used (inputs). It also has incentives for improved efficiency over the lifetime of the contract. The contract provides flexibility for the Department to decide the most desirable point for re-competition. In the event of supplier failure, total claims are limited to the operational charge for the previous year (around £300 million) and for projects, liability is limited to the greater of £50 million or 150 per cent of the project costs at the point of failure. It also includes exit clauses covering information provision and staff transfer issues but these may need to be revisited closer to the end of the contract to ensure they are up to date with the Department's needs.

1.17 The Committee of Public Accounts' report on successful partnership in Public Finance Initiative projects[18] recommended mechanisms to ensure continued value for money over the lifetime of the contract such as benchmarking, open-book accounting, contract flexibility, appropriate change procedures to reduce the risk of contractors increasing profit margins and appropriate risk sharing. ASPIRE includes these features and, compared to the contract it replaced, pays the supplier on the basis of performance rather than resources used. ASPIRE has a number of benefits **(Figure 6)**. Project trials, governance arrangements, and open-book accounting should provide the Department with the necessary cost information to benchmark prices and identify cost variances and value for money.

18 Committee of Public Accounts: *Managing the Relationship to secure a Successful Partnership in PFI Projects* (42nd Report, 2001-02).

5 Financial evaluation of bids

Bidder	Initial bid £ billion	Bid After Negotiation £ billion	Percentage difference between Should Cost Model bid (£3.595bn) and Bid After Negotiation from other bidders
Should Cost Model	2.87	3.595	n/a
RPS (EDS/Accenture)	2.4	2.798	22% lower
Capgemini and Fujitsu	2.78	2.83	21% lower
Fusion Alliance	2.77	Bid not taken forward	n/a

Source: National Audit Office analysis of HM Revenue and Customs data

NOTES

1 The Should Cost model (SCM) was used as a proxy Public Sector Comparator and constructed based on industry research into prices, margins and productivities to create a 10-year target price for the contracted service volumes over the life of the ASPIRE contract.

2 The Should Cost model and the bids changed during the negotiations due to the introduction of new requirements, changes in the contractual volumes, additional third party contracts and an increase in the Department's asset base.

6 Expected benefits from the ASPIRE contract

- All IT projects developed under the ASPIRE contract will have individual business cases agreed between the Department and Capgemini that will identify the potential savings and benefits from implementation and milestones for successful project implementation. Capgemini are paid on the basis of implementing the projects to agreed milestones.
- Capgemini to provide technology-enabled change to the Department to enable the expected benefits arising from the O'Donnell and Gershon reviews.
- The Department is able to obtain an equal share of profits the suppliers make in excess of the contract target margin through a 'performance gain share' mechanism.

Source: National Audit Office analysis of HM Revenue & Customs data

1.18 From July 2003, the Inland Revenue was aware of the possibility of a merger with HM Customs and Excise and during the negotiations with the two preferred bidders selected in July 2003 included clauses to deal with machinery of government changes. The two former departments had very different IT strategies and contracts. During the ASPIRE procurement, the Inland Revenue instructed bidders to ignore the possible implications of the O'Donnell review, while independently both departments sought to ensure that their contracts had sufficient flexibility to deal with a possible merger. But throughout the development of the ASPIRE procurement strategy and the negotiation, the Departments did not discuss with each other how their respective strategies and contracts could be aligned or combined in the event of merger.

The Department's management of the procurement process

1.19 In managing the procurement, the Department:

- **Built relationships with potential suppliers and maintained relations with the incumbent supplier.** The Department's team had experience in procurement and knowledge of the business. It completed the task on time to ensure that the new contract would be operational in time for the end of the EDS contract.
- **Followed existing guidance and good practice (Appendix 3).** The Office of Government Commerce (OGC) Gateway 3 report on the stages up to the award of the contract concluded that the ASPIRE project team had maintained an effective competition which had been run to the highest standards and resulted in a sound evaluation. The OGC Gateway team also commented on how recommendations from its earlier review had been addressed. This indicated a willingness to acknowledge and implement advice, good practice and lessons learnt during the project lifecycle, not just in retrospective assessment.
- **Drew on the lessons from the contracts which ASPIRE replaced** (see Appendix 4), and took on board recommendations from the Committee of Public Accounts' reports on the IR/EDS strategic partnership[19] and the NIRS2 contract extension[20] such as dealing with potential barriers to competition and increasing contract flexibility.
- **Used professional advisers to provide expertise** in particular areas, although the emphasis was on using in-house expertise as much as possible so that there would be sufficient knowledge, skills and continuity in the Department once the procurement and legal advisers were released. The total cost of advisers during the procurement process was just over £9 million. The Department has drawn out lessons from its use of consultants, but has not evaluated the consultants' performance and quality of advice.

1.20 Although it is difficult to get precise benchmarks the procurement costs and timescale of ASPIRE compares favourably with other contracts. The Department's business case for the procurement estimated total costs of procurement at around £30 million but actual costs were just over £27 million. **Figure 7** shows the breakdown of ASPIRE procurement costs compared with budgeted costs and as a percentage of the total value of the deal.

1.21 In most PFI deals, industry benchmarks point towards a figure of around three per cent for procurement costs as a proportion of contract value. In comparison procurement costs for ASPIRE represented less than one per cent of the expected value of ASPIRE which may in part reflect the scale of the contract. Including transition costs the total is some two per cent of the contract value. HM Treasury's report on PFI projects[21] found that procurement and bid costs can be high in relation to the project's capital value for small PFI schemes.

19 Inland Revenue/EDS Strategic Partnership: The Award of New Work (28th report 1999-2000).
20 NIRS2 Contract extension (38th Report 2001-02).
21 HM Treasury 'PFI: Meeting the Investment Challenge' July 2003

7 Procurement costs

Procurement cost	Budget (£m)	Actual spend (£m)	Percentage overspend or (underspend) against budget	Actual spend as a percentage of the value of ASPIRE (£4 billion)
Advisers	10.1	9.5	(6)	0.2
Design and implementation studies running costs	3.3	3.1	(6)	0.08
Departmental staff costs	4.3	5.7	33	0.1
Due diligence	3.4	0.9	(74)	0.02
Contribution to bidders' Design & Implementation studies and Invitation to Tender response costs	7.7	7.7	–	0.2
Other operating costs	0.8	0.6	(25)	0.02
Total	**29.6**	**27.5**	**(7)**	**0.7**

Source: National Audit Office Analysis of Department's procurement costs

1.22 The Committee of Public Accounts in its report on the redevelopment of West Middlesex Hospital[22] was concerned about costs exceeding budgets, recommending that departments learn from previous procurements and ensure that sensible budgets are set and adhered to. The Committee also commented on the high cost of advisers and encouraged departments to drive down advisers' costs. On health procurements, PFI advisers' costs have averaged 3.7 per cent, ranging between one and eight per cent. In comparison, advisers' costs on ASPIRE were less than half a per cent of the original deal value.

1.23 Faster procurements have the advantage of reducing procurement costs. From publishing the OJEU notice to signing the contract the ASPIRE procurement process took 21 months, compared with a typical procurement timetable for IT systems within the NHS of about three years, and 18 months to two years for a single major PFI project. But recent procurements such as projects within the NHS National Programme for IT have been completed within a year.

22 The PFI contract for the redevelopment of West Middlesex University Hospital – 19th PAC Report 2002/03 HC155.

PART TWO
The transition

This part of the report examines how the Department managed the risks in changing supplier during the period up to the start of the new contract; and whether services were maintained during the transition period and IT projects progressed. It looks at the timescale of the transition and how much the transition cost. It also considers how well the transition of NIRS2 was managed.

Managing the risks in changing supplier

2.1 The change from one supplier to another was the first of this scale in the public sector[23] and posed significant risks to maintaining the Department's services (Appendix 5). During the procurement phase the Department concluded that there were no 'critical' risks in retaining EDS, but if Capgemini were selected a number of risks would need to be managed. The Department's evaluation of the Capgemini bid concluded that it had well developed plans to manage the risks.

2.2 During the main transfer period which ran from January to July 2004:

- the incumbent (EDS) had to maintain the Department's IT while assisting the incoming supplier (Capgemini);
- the incoming supplier had to learn the business and get ready to run IT service from the start of the new contract; and
- the Department had to manage the relationships between the suppliers **(Figure 8 overleaf)**, for example, to ensure that there was sufficient accommodation during the transition for Capgemini to work alongside EDS.

2.3 The smooth transition was helped by the cooperation of EDS and the positive working relationship between EDS and Capgemini. The Department carefully developed working relationships with EDS and Accenture and built similar partnerships with Capgemini and Fujitsu over the course of the competition. It was supported by exit clauses in the Eagle contract which the Department had negotiated in 2002, binding EDS to provide a certain level of support and information to any incoming supplier and formed the basis for sensible arrangements between the parties. EDS also wanted to maintain its reputation and exit on good terms.

23 The Driver and Vehicle Licensing Agency changed IT suppliers following open competition in 2002, but its new contract is on a much smaller scale than ASPIRE.

8 Roles of the incumbents, incoming suppliers and the Department during the transition

Party	Key roles
Incumbent suppliers (EDS and Accenture)	■ To deliver ongoing IT service and project development according to contractual service levels and agreed plans up to the end of 30 June 2004 ■ To fulfil all exit and termination responsibilities
Incoming suppliers (Capgemini/Fujitsu)	■ To plan and execute transition activities on time to provide contracted live service levels from the start of the new contract from 1 July 2004 ■ To transfer staff from the incumbents ■ To transfer or replace 3rd party contracts used by the incumbents ■ To minimise the costs of transition
Department	■ To facilitate relationships between the incumbents and incoming suppliers ■ To provide necessary accommodation and facilities for the incoming suppliers ■ To enforce exit clauses agreed with the incumbents ■ To monitor agreed service levels and project development against agreed plans ■ To identify key incumbent staff to ensure they were available to the new contract ■ To manage the costs of transition

Source: National Audit Office

The transition timescale

2.4 The main transition from EDS to Capgemini was completed within the expected time frame of six months. Key activities included:

- **securing high levels of staff transfer from the incumbents** so that when the new supplier started to run live service it would be using staff with a detailed knowledge and understanding of how the IT supports the Department's business activities. Of the 2,928 EDS staff in post, around 96 per cent (2,811) transferred to Capgemini by June 2004, under Transfer of Undertaking and Protection of Employment (TUPE) conditions. Capgemini achieved this by running the staff transfer as a stand-alone project, putting on road shows, and offering incentives such as comparable employment conditions and pensions. Also EDS helped by communicating with its staff about transfer issues and agreeing to fund the £65 million pension shortfall of staff transferring.
- **securing the transfer of designated key staff.** The Department and Capgemini identified 280 key staff, of which 224 (80 per cent) transferred. The loss of key staff was a major risk, but its effect was reduced by the various exit clauses negotiated by the Department. For example, there was provision for some EDS staff that did not transfer to remain available to support Capgemini for a year after the end of the EDS contract, although the Department only utilised this resource for three months. Capgemini also filled potential vacancies of staff that would be leaving at the end of the EDS contract and work-shadowed areas where key staff were likely to leave. From the start of transition, staff were only permitted to leave EDS business with the Department when Capgemini confirmed that they had adequate cover in place.
- **the transfer of third-party contracts used by EDS to deliver and support IT services.** Under the original contract, EDS had sub-contracted much of its work to third-parties, so their loss could have had a significant impact on service delivery. During the transition, 226 such sub-contractors were being used by EDS. Capgemini and EDS working with third party suppliers successfully transferred 219 (97 per cent) of these, with the remainder either replaced or no longer required.

Transition costs

2.5 EDS estimated its transition costs would be £4.4 million if it had won the new larger contract, mainly comprising additional staff costs. By choosing Capgemini the Department incurred £37.6 million in Unique Transition Costs paid to Capgemini and around £5.3 million in exit costs to EDS and Accenture **(Figure 9)**. Unique Transition Costs were those costs identified by the supplier and agreed with the Department which would not have been incurred had the existing suppliers continued to provide all or part of the IT (they covered the need: to encourage the EDS workforce to transfer to ensure continuity of service; to relocate services from EDS web-hosting premises to Fujitsu; to review work in progress to identify the cost to complete and the IT solution; and to replatform NIRS2 and relocate from Accenture to Fujitsu sites). They included a profit margin to the new supplier of 15.5 per cent (which was a discount on the normal gross profit margin before overheads). The Department had agreed to fund such costs as a way of stimulating competition during the early stages of the procurement process.

9 Transition costs

Category	Amount (£ million)
Unique Transition Costs to Capgemini/Fujitsu	37.6
Transition support costs to EDS/Accenture	5.3
Departmental staff and running costs	1.3
Consultancy advice and support	2.4
Department for Work and Pensions and IT support costs for NIRS 2 transition	0.5
Retained staff costs for EDS	0.4
Total costs of transition	**47.5**

Source: National Audit Office analysis of HM Revenue and Customs data

NOTES

The £3.4 million of UTCs paid to Capgemini/Fujitsu for NIRS2 transition is included in the £37.6 million.

The Accenture transition support costs of £3.4 million are included in the £5.3 million.

2.6 The Committee of Public Accounts in its report on “Delivering better value for money from the PFI” (HC 764) in June 2003 recognised that imposing excessive costs on bidders is likely to result in higher charges in the longer run and might deter firms from bidding. The C&AG’s report on “London Underground PPP: were they good deals” (HC 645) in June 2004 recognised that in some cases departments may not be able to develop sufficient competition without reimbursing bid costs. It also concluded that, after conceding the principle of reimbursing the losing bidders, departments should take care to control the extent of reimbursement.

2.7 Capgemini’s first estimate of Unique Transition Costs of £75 million was provided whilst it was in contract negotiations with the Department in October 2003. After awarding the contract, the Department estimated that it would have to pay transition costs of around £40 million **(Figure 10 overleaf)**. The estimate was set at around 10 to 15 per cent of the new contract’s first year value and the Department achieved outturn at the lower end of this range (Figure 10). As the details of the transition became clearer from Capgemini’s plans, the Department agreed to increase the budget to £52 million. However, the Department and Capgemini did not agree the detail of what would qualify as a unique transition cost until the transition had started. Although individual unique transition cost payments were generally well controlled, valuable resources and time were taken up during transition negotiating whether a cost was unique or not. Capgemini submitted its financial estimates for unique transition costs, which were scrutinised by the Department before it provided guidance on which items would not qualify and which were likely to qualify, subject to detailed examination of the elements of expenditure.

2.8 The actual first year profit for ASPIRE is likely to be £53.9[24] million, compared to a target margin expectation of £38 million, both of which represent a 10 per cent profit margin. The absolute increase is due to an increase in the Department’s demand for IT and the target margin percentage of 12.3 per cent is not likely to be achieved. If the target profit margin had been exceeded, the Department would expect a 50 per cent share in the excess profits.

24 Based on provisional figures.

10 Unique Transition Costs – outturn against estimates (£ millions)

Category	Estimated in business case after award of the contract (£ million)	Outturn (£ million)	Outturn as a percentage of the estimated contract spend in the first year (£384 million)
Capgemini transition costs	32.5	37.6	9.8
EDS/Accenture transition and support costs	12.0	5.7	1.5
Total	**44.5**[2]	**43.3**	**11.3**

Source: National Audit Office analysis of HM Revenue and Customs data

NOTES

1 In preparing for the transfer, the Department also incurred £14 million for the rights to use NIRS2 after the termination of the contract although the intellectual property rights remained with Accenture. This represented a closing payment as part of the 1995 PFI contract.

2 Subsequently increased to £52 million by the Department to reflect Capgemini's transition plans.

The transition's impact on services

2.9 EDS were responsible for maintaining IT service delivery during the transition period. In this period, the chances of disruptions were greater than normal because additional demands were made on EDS to support Capgemini and fulfil exit clauses. EDS had to maintain service levels for 250 IT systems to support the Department's business, for upgrading systems and for progressing project development work according to agreed plans. For example, during the transition period the Department's IT systems issued 8 million income tax self assessment statements and 870,000 corporation tax notices to file, processed 9.7 million annual tax codings reviews. It was also necessary to complete around 80 IT upgrades.

2.10 Because of the perceived risks to service delivery, in October 2003 the Department commissioned Gartner, an IT consultancy firm, to review its internal arrangements for the transition. The report identified as a key risk the lack of an agreed transition plan between the incumbent and new suppliers. Until the contract with Capgemini was signed in January 2004, all the parties concentrated on negotiating a contract, and very little time was left to plan the transition, especially as the same personnel were involved in both. The transition plan from Capgemini was delivered incrementally as monthly plans for each of the first three months. The monthly activities included discovery tasks that influenced and clarified the task list for the following month. The complete detailed plan taking the project through the live implementation date and beyond was not available until March 2004. EDS as the incumbent supplier considers that the delay in producing a more detailed transition plan made it more difficult to plan its likely resource allocation in advance. The Department had used the period from the start of August 2003 to the contract award in December 2003 to develop and test transition plans. There were no major disruptions in services, and the incumbent's performance remained steady during the transition period. The Department paid EDS around £2.3 million over and above normal running costs to provide the necessary support for the transition.

2.11 Changing suppliers also increased the risk that ongoing projects and IT development would be delayed and project costs would increase. The Office of Government Commerce advises that departments should have a stable business environment during transition and the early stages of a contract. An independent review of the Department's transition planning arrangements recommended the implementation of a 'safety zone' around the transition to avoid high volumes of change and reduce the pressures on the outgoing and incoming suppliers. At the time of the transition the Department had nearly 100 projects valued at £439 million in development, including several 'business-critical' projects with tight legislative deadlines. Additional demands for IT projects associated with the creation of the new HM Revenue and Customs Department also emerged at this time. Because many of the ongoing projects were time-critical, the Department decided that development work should continue during transition and scheduled IT releases should be delivered according to plan. During transition, EDS delivered scheduled IT releases and worked with Capgemini to develop project plans. The ASPIRE contract provides for an extension of up to eight years which gives the Department some flexibility to time any re-competition when there is less ongoing project development work underway.

The transition of NIRS2

2.12 Under ASPIRE, the Capgemini and Fujitsu consortium took over responsibility for the running of NIRS2 from Accenture in January 2005. The transfer of NIRS2 was run as a separate project to the main transition with a budget of £16.2 million. The Department paid Capgemini £3.4 million in unique transition costs and Accenture £3.4 million for support during the transition **(Figure 11)**. However the transfer of NIRS2 IT data systems from Accenture to Fujitsu proved to be more difficult than expected and the previous contract with Accenture had to be extended (Appendix 8). The Committee of Public Accounts' report on "NIRS2 Contract extension" (38th Report 2001-02) highlighted the challenge that the Revenue would face in 2004, especially in terms of learning and set up costs for these large and complex systems in a deal likely to be worth over £4 billion. The Committee considered that the methodologies the Department used to estimate and benchmark proposals would need to be rigorous.

11 Total costs to the Department of re-platforming NIRS2

	Actual costs (£ million)
Capgemini transition costs	3.4
Accenture support costs	3.4
Costs incurred by the Department for Work and Pensions	0.5
Transition costs[1]	**7.3**
Capgemini contract costs for NIRS2	7.6
Total[2]	**14.9**

Source: National Audit Office

NOTES

1 Includes the £2 million paid by the Department for the delay in re-platforming NIRS2.

2 The Department's forecast of the cost of transferring NIRS2 was £16.2 million. In preparing for the transfer, the Department also incurred £14 million for the rights to use NIRS2 after the termination of the contract although the intellectual property rights remained with Accenture. This represented a closing payment as part of the 1995 PFI contract.

2.13 Capgemini/Fujitsu encountered problems with NIRS2 re-platforming and the Department requested changes. Capgemini retained Accenture as a sub-contractor under ASPIRE and rescheduled the work in phases which were completed in September 2005 at a further cost of £2 million. The cost of completing the migration in the deferred timescale was £9.9 million. Capgemini/Fujitsu has paid £7.9 million and the Department £2 million. Although the delays did not affect service delivery, the system was implemented at the end of August 2005 but was not fully operational until November 2005. The NIRS2 service was maintained successfully throughout the transition process.

2.14 The transfer of NIRS2 was more difficult than the main transition because:

- The nature of the terms of the existing PFI contract with Accenture meant that the Department had to agree a set of exit procedures with Accenture and therefore was able to disclose key information about the system to assist the incoming supplier during due diligence.
- Capgemini's transition plans proved ambitious given its level of expertise in the design and operation of the system.
- Initially the degree of collaboration between the incumbent and the incoming supplier was not as strong as in the main transition but Accenture did meet its obligations under the agreed exit provisions.
- The nature of the PFI agreement meant that the Department had limited in-house knowledge of the IT used in NIRS2.
- Accenture's workforce was less willing to transfer to the new supplier.

2.15 The Department has taken steps in ASPIRE to avoid similar problems occurring in future re-competitions, for example by including measures that will allow for more extensive sharing of information with bidders during due diligence.

PART THREE
Management of the contract

This part of the report considers the initial performance of the supplier from the start of the contract and what the Department is doing to manage the contract. It examines the level of service the new supplier has provided from day one of the contract, the delivery of the Department's main IT projects since transition and the cost and flexibility of the ASPIRE contract to deal with change.

Initial performance

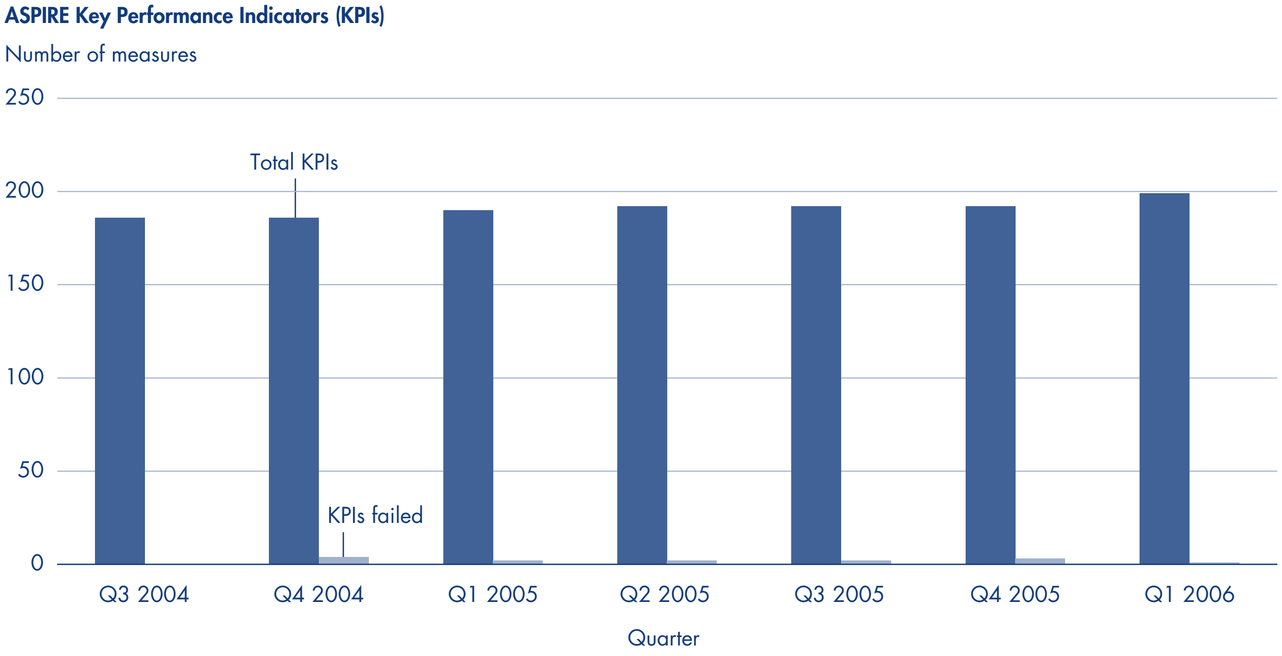
3.1 The risks that need to be managed in embarking on a new contract with a new supplier (Appendix 5) include ensuring that the new supplier will be able to deliver services from day one, maintaining ongoing project progress to time and cost, controlling costs for new work and ensuring that the expected benefits of ASPIRE are realised.

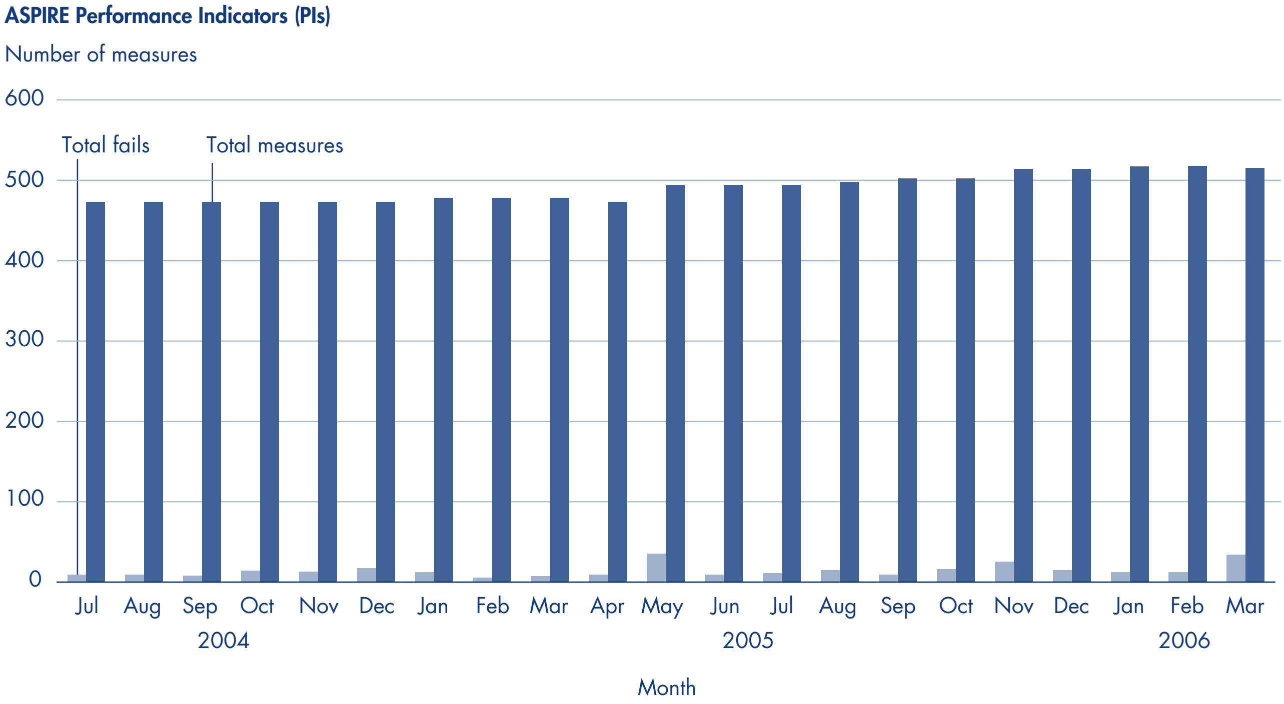
3.2 The partnership between the Department and Capgemini has provided IT services from day one of the contract, maintaining service continuity in performance during transition. There are over 500 performance measures, of which some 200 are key performance indicators (KPIs) and carry service credits. Performance indicators cover different aspects of delivery ranging from running live service, to achieving productivity targets and delivering business-critical projects. Since the transition ASPIRE's performance on delivering IT services overall has met or exceeded target levels. However there have been eight IT system failures which led to £2.67 million in terms of service credits in the first contract year **(Figure 12 overleaf)** but they did not relate to major business disruptions. The Department's new governance arrangements to manage the partnership include: operational meetings; a monthly commercial issues forum; and a Joint Partnership meeting that considers contract changes, performance trends and relationship issues.

The delivery of business-critical projects

3.3 It was important for the Department to establish what work had been completed, the stage the project had reached and that it resolved any outstanding issues regarding payment. The Department could then establish what work the new supplier needs to do to complete the project and ensure that it only pays the new supplier for new work. The Department, in conjunction with the new supplier, undertook a health-check at the start of the contract to assess the risks to business-critical projects and specify how ongoing projects would be delivered to agreed cost, time and delivery outputs. They found that different standards were being applied across different projects, for example eight different change processes were in operation. Some projects had incomplete information and they considered that there had been some under-investment in IT under the previous contract. Some systems needed updating and some projects had been held back by the Department until the end of transition. As a result, in the post-transition period there was a need to revisit milestones and delivery timescales. All these factors added risk to the early stages of the new contract.

12 Capgemini's performance against HM Revenue and Customs Performance Indicators





Source: National Audit Office analysis of HM Revenue and Customs ASPIRE performance data

3.4 Since ASPIRE began the supplier has successfully delivered a number of major IT software releases for business-critical projects aimed at introducing efficiency improvement, better data, service quality and management information and responding to legislative changes. But there have been some delays and cost increases on business-critical projects, which have on the whole been caused by the Department changing its requirements **(Figure 13)**.

13 Progress on business-critical projects under ASPIRE

Project	Timescales	Project Budget as at March 2006 (£million)	Spend to March 2006 (£million)	Progress
Construction Industry Scheme	Implementation of release 3 (first live release) April 2007. Release 4 by 31/10/07, Release 5 by 05/04/08.	123.4	72.9	Implementation delayed from April 2006 to April 2007 to allow industry and IT suppliers to prepare for changes and for HM Revenue and Customs to build industry confidence in the system. HMRC and ASPIRE planning to complete majority of IT development by August 2006. Budget now reflects cost of deferral and latest ASPIRE cost estimates.
On-line services	2000/01 – 2007/08	697.3	368	Some projects have been rescheduled due to specialist IT resource constraints. The 'On-line services' programme has ceased to exist since April 2006 as it has been amalgamated into the Customer Contact Transformation Programme.
External Routing Interface Component (ERIC) and Modernisation of PAYE processes: MPPC1, EOY06 and MPPC 2	Phase 1 staged release from April 2005 - Jan 2006. EOY06 – April-July 2006 MPPC2 – April 2007	205	170	Phase 1 implemented. EOY06 – Releases 1 and 2 implemented. Release 3 on schedule for delivery on 3 July 2006. Phase 2 - Releases 0 and 1.0 implemented. Subsequent releases on schedule.
Better data for CT	Various releases to April 2007	66.7	30.1[1]	One release (2b) has been deferred for four months, two other releases have been delivered on time and two others deferred from November 2006 to April 2007 to ease pressure on online service resources.
Modernising Stamp Duty	Project closed 31 Dec 2005	113	105.7	Delivery of IT could not be achieved by December 2003 timetable, so the Department phased the release of the IT between July 2004 and February 2005, with contingency arrangements in the event of potential IT problems. The full e-channel element was deferred until July 2005 due to a shortage of web solutions resources.
Child Trust Fund and Child Benefit system replacement	Various releases to April 2006	163.2	69.5[2]	Child Trust Fund delivered to time cost and quality. Development of the Child Benefit 2 system at February 2006 was suspended pending a business review of cost/benefit analysis and alternative technical options.

Source: National Audit Office analysis of HMRC project costs

NOTES

1 Spend to date figure to May 2006.

2 Figures are provided up to November 2005 as the project stopped being classified as business-critical in December 2005.

Cost of ASPIRE

3.5 The cost of the contract in the first year has been more than the Department originally planned. Shortly after the contract was awarded in December 2003 the Department estimated a spend of £384 million (excluding VAT) in the first year of the contract based on 2002-03 volume of IT demand which was used in the invitation to tender. Actual spend in the first year from July 2004 to June 2005 was £539 million (excluding VAT). The Office of Government Commerce Gateway 4 Review (readiness for service) in June 2004 expressed concerns over the requirements and timescales of 'work in progress' projects. It noted that costs had risen due to increased volumes of service requirements and recommended that these costs be clarified and refined.

3.6 The main reason for the increase in the cost of the contract in the first year has been a 132 per cent rise in the Department's spending on projects, covering systems development and enhancement (an increase of £98 million) and a 117 per cent increase in consultancy (an increase of £27 million) **(Figure 14)**. This has been due mainly to unexpected work involved in the New Tax Credits Programme, Modernising PAYE Processes for Customers, the introduction of the Child Trust Fund, Reform of the Construction Industry Scheme, Modernising Stamp Duty and significant changes to the Departmental infrastructure, which was not planned when the Department awarded the contract. There has also been increased demand for some IT services, and the retention of Accenture to provide application development support to NIRS2 will add an extra £8.04 million to costs in the first three years of the contract. This has generated a profit for Capgemini which is likely to be £53.9 million[25] compared to a target margin expectation of £38 million; however both represent the same profit margin of 10 per cent. But Capgemini does not expect to achieve the target profit margin of around 12.3 per cent so it is unlikely that any profit share will accrue to the Department for the first year.

3.7 There was a risk that when the Department transferred from one supplier to another it could affect planned progress on projects. The new contractor's team was likely to take time to get up to speed on projects in progress. It might have been unrealistic to expect the new supplier to sign up to the productivity regime that controls the development projects when they had not been involved fully from the start in initial estimates through design element and authorisation. The Department decided that all the ASPIRE terms would be phased in incrementally for software projects underway. It considered that bidders might be deterred by the prospect of taking on nearly 100 existing projects, valued at £439 million, with outputs and timetables they had not planned. It decided to pay the new supplier for ongoing projects on the terms of the old contract which stipulates payment on the basis of resources used but using the costs agreed under the new contract. Capgemini's staff cost rates appear higher than those under the previous contract because they include overheads that were charged separately under the previous contract. While this may have helped maintain competition by persuading bidders that a new supplier would not be bound by the existing project delivery plans, it meant that the Department were delayed in achieving some of the delivery assurance benefits of the new contract, which stipulates payment on the basis of performance achieved rather than resources used.

3.8 The need to control costs is reinforced by the increase in the costs of the previous contract due to an increase in the Department's demand for IT services. When the Department awarded the 'Eagle' contract in 1994 to EDS it was valued at £1 billion (which excluded price indexation or growth), by 2000 the Department estimated that it would cost £2 billion and the final spend under the contract was £2.5 billion; on the whole this can be attributed to the Department's increased demand for IT. This new contract has thresholds on the demand for IT services to trigger some reappraisal of the supplier's charge rates. As the Department's volume of work increases it expects to obtain discounts on unit price and consequently a reduced price based on economies of scale. However this can result in price increases where the supplier has been unable to avoid extra costs. Some of the thresholds have been exceeded in the first year and the Department has negotiated some price changes with Capgemini which resulted in a minor price increase and three significant price reductions.

25 Based on provisional figures.

14 Cost increases on ASPIRE during the first year of the contract

Service/Project	Forecast charges (£ million)	Actual charges (£ million)	Increase (decrease) of actual compared to forecast (£ million)	Percentage increase (decrease)
Service Lines				
Operational Service Charges	266.3	298.0	31.7	12
Service Credits (penalties)	(1.3)	(2.7)	(1.4)	108
Project Lines				
Business Applications Development and enhancement projects	74.0	172.0	98.0	132
Integration	16.0	11.0	(5.0)	(31)
Desktop Applications	6.0	11.0	5.0	83
Rate based services (consultancy)	23.0	50.0	27.0	117
Total	**384.0**	**539.3**	**155.3**	**40**

Source: National Audit Office analysis of HMRC forecast and actual spend of ASPIRE

3.9 The Department's financial model for ASPIRE forecasts spend to decrease slowly but remain broadly flat over the contract term. If the first year spending on the contract, particularly IT projects, continues at the same level over the lifetime of the contract, the final cost of the ASPIRE contract could be in excess of £6 billion rather than the originally projected £3 billion to £4 billion. This does not take account of any impact of the merger of the PFI Fujitsu contract. This raises the question how the Department will fund the additional spending on IT under the new contract. The additional funding agreed on the project budgets is either funded by Treasury ring-fenced funds or additional allocations at the start of 2004-05 or in year. Allocations are approved by the Department's Executive or Operating Committees. The Department expects that this level of demand for IT services will not be sustained because it considers the demand for IT services will decline because of its targets for reducing staff levels by 12,500, an increase in the use of electronic services replacing printing, and its aim to reduce spending on IT to less than 20 per cent of the Department's budget. The Department forecasts expenditure in the second year of the contract to be around £800 million but it does not have an estimate of the likely total cost of ASPIRE as it considers it is difficult to predict the level of IT demand, price changes and changes to the Department's activities over the lifetime of the contract.

3.10 Comparisons of the profit margin on ASPIRE with other contracts are not straightforward. There are few good up to date comparators to use, especially as the approach to IT solutions changed in 2003 when the Treasury decided against using PFI for IT projects. But the comparators below suggest that the percentage profit margin in ASPIRE is within the range of other contracts. Capgemini's target profit margin ranges from 5.6 per cent to 27.2 per cent across the services it provides but its average profit margin under ASPIRE is 12.3 per cent **(Figure 15 overleaf)**. The four project lines are higher than the average and the main software development line is 14 per cent. This compares to 16.9 per cent the Department used in the Should Cost Model and the actual margins on the previous contract with EDS which ranged from 13.5 per cent to 26.5 per cent. A PricewaterhouseCoopers study on PFI rates of return since 1997[26] covered over 60 schemes and illustrated the range of rates of return, depending on the size and complexity of the project and the allocation of risk. The study showed a decline in nominal rates of return from 13.5 per cent to 10 per cent by 2001, the projects covering areas such as health, education and transport but excluding IT projects. The NHS National Programme for IT contains target profit margins between seven and 19 per cent, depending on negotiations with each individual contractor for particular contracts. Other PFI deals tend to have higher margins.

26 HM Treasury *PFI: Meeting the Investment Challenge*, July 2003 Annex C – PricewaterhouseCoopers Rate of Return Study.

15 Comparison of the profit margin on ASPIRE with other contracts

	Profit margin
ASPIRE range of profit margins	5.6–27.2%
ASPIRE average profit margin	12.3%
ASPIRE IT project development profit margin	14%
Department's Should Cost Model profit margin	16.9%

Project	Contractor	Profit Margin
EAGLE (previous contract)	EDS	13.5–26.5%
PFI (ISA) contract with former HM Customs and Excise	Fujitsu	12.97%
PFI hospitals[1]	Various	18-23% on initial projects, 12-17% on more recent projects
NHS National Programme for IT[2]	Various	7-19% target
PFI various schemes[3]	Various	10 -13.5%

Source: National Audit Office analysis of contract profit margins

NOTES

1 Department of Health released figures February 2005 – pre-tax nominal projected rates of return for contractors on PFI Hospitals.

2 Pre-tax rates of return from the NHS National Programme for IT contract.

3 "PFI: Meeting the Investment Challenge" – PWC study on PFI rates of return since 1997 which covered 64 PFI schemes and illustrated the range of rates of return, depending on the size and complexity of the project and the allocation of risk. The projects covered areas such as health, education and transport but excluded IT projects.

4 The annual profit margin on the NIRS2 contract since it was amended in 2000 ranged from 25.9% to 39.7%. This was a significantly smaller contract than EAGLE or ISA.

Acting as an intelligent customer

3.11 Relations with the new supplier have been helped by having a separate HM Revenue and Customs commercial management team to oversee the commercial aspects of the contract, leaving the Department's service line managers and supplier teams to concentrate on meeting business needs. Continuity has been helped by high rates of staff transfer from EDS to Capgemini. The ASPIRE contract identified the key supplier people to remain on ASPIRE for a period after the contract started. In contrast to the fifteen Departmental staff involved in the procurement stage only one remained in post soon after the award of the new contract as the Department set up a new contract management team. The Department has some 1,950 information management staff including those working in the areas of technical solutions, project support, risk assurance and business solutions. The Department is seeking to reduce the ratio of its own information management staff compared to the supplier team from 30:70 to nearer 20:80, to over time reduce the Department's total Information Management workforce (including civil servants, contractors and supplier staff) from 6.3 per cent to no greater than five per cent of the Department's total workforce and to reduce expenditure from 24 per cent to less than 18 per cent of the Department's running costs. These targets can however be significantly affected by changes to the legislative agenda.

3.12 Capgemini has introduced mechanisms to support the successful delivery of the Department's IT needs including:

- Bringing together managers from the Department and from the suppliers to collaborate and share ideas on IT solutions known as Accelerated Solution Environments.
- Working with the Department to start to reduce the number of IT data centres and identify process efficiencies in creating business cases supporting IT investments.
- Developing a system to choose subcontractors that match the Department's needs
- Involving the Department in discussions with third party suppliers such as BT.

Evaluation of supplier and contract performance

3.13 The Department is changing the way it manages the IT contract with the new supplier as the new contract is more focused towards service delivery and productivity. But the Department has taken 18 months to get an overall view of how the contract is performing and to put into effect the full arrangements for managing the contract, which include:

- **Service line managers** working with Capgemini to forecast demand and review supplier service levels against the range of performance indicators and targets. It has taken around nine months to get effective bottom-up forecasting from Capgemini staff (previously EDS), more used to input-based pricing. In the first year the Department's estimated service activity limits in the contract have been breached.
- **Performance measurement.** The previous targets under the Eagle contract have been adopted and increased for actual performance achieved. Following the integration of the former Customs ISA contract, the Department is reviewing the number of performance measures it has to identify gaps as part of a wider service improvement programme with a view to implement them by April 2007. Until then the Department assesses the contractor's performance through progress on pilot trial projects, performance against targets, live service running, financial statements showing actual costs and profit margins and progress on major projects. The Department has also agreed in principle with Capgemini and Fujitsu to establish baselines to support new measures of performance on end-to-end live services to the desktops for incorporation from April 2007.
- **Proposals for new work.** For the period July 2004 to March 2006, 188 new work proposals were presented by the Department's business areas. The Department defines its business requirements and the supplier provides a proposal to meet those requirements with trials and quality testing before becoming operational. The supplier pays rebates/penalties where delivery is delayed. The Department pays the supplier for meeting success criteria for interim milestones and only pays the final element of the supplier's profit margin after six months of successful live running.
- **Procedures for dealing with change.** The Department is using a financial model to manage changes in the contract which shows the effect on price and therefore on payments to the supplier. Apart from the caps and collars on service lines which allow the Department to review the prices for IT service demand volumes, the supplier can only change price in response to a change of requirement and the Department can only change price if benchmarking with other suppliers' prices suggests the price no longer represents value for money. The Department has translated contract changes in the first year of the contract to show the impact on the original price (using the Should Cost Model) which shows the cost of the contract is £4.1 billion with provision for inflation based on 2002-03 volumes.
- **Benchmarking.** The Department is monitoring the supplier's margins on services and consultancy/project related work. The Department has a performance gain share mechanism which starts with an open book audit. This audit was completed in April 2006 but some work has continued to determine the profit for the first year of the contract. This work is ongoing at end May 2006 and there is at that date no accrued profit share as Capgemini has not made its target profit margin. As part of the overall negotiations to integrate the PFI Fujitsu contract with the ASPIRE contract, the Department has agreed an initial benchmarking programme to begin in July 2006. The aim is to benchmark all of the services within the contract on a rolling basis throughout the remaining life of the contract. Outside that plan there is provision to benchmark any new service or any element on an ad hoc basis. For example, it has contracted an independent company to benchmark server prices and has used the results to challenge the supplier's proposal. With the change of supplier and contract (from input to output-based pricing) it has taken until January 2006, about 18 months into the new contract, for the performance of the new supplier to bed down. The Department had originally intended to produce an annual value for money report in November 2005 but now intends to produce a financial scorecard and a customer service assessment reporting mechanism in late 2006 to assess the supplier's overall performance. The Department's comparison of the first year's costs with the Should Cost Model (updated for contract changes), showed that ASPIRE cost £71.8 million less than the Should Cost Model.
- **Education and guidance for staff** on how to obtain IT services from the supplier, explaining roles, responsibilities and timescales under the new contract.

Renegotiating ASPIRE to take on the former HM Customs and Excise's PFI IT contract

3.14 The former HM Customs and Excise and the Inland Revenue had different IT strategies and their respective IT contracts did not reflect the likelihood of merger in 2005. By then, the former Inland Revenue had the ASPIRE contract delivering its IT requirement and the former HM Customs and Excise had signed a revised contract (ISA) with Fujitsu in 2003 to provide IT infrastructure services. The services delivered by the contracts are fundamentally different – ASPIRE provides IT services including IT infrastructure and applications development whereas the PFI contract provides IT infrastructure - but HM Revenue and Customs believes that the ASPIRE contract will be flexible enough to deal with the merger of the two Departments, and this now needs to be proved in practice.

3.15 The O'Donnell review[27] in March 2004 found that while there had been some communication between the departments, there had not been joint consideration of the best solution for the provision of IT. HM Revenue and Customs has new IT requirements which were not envisaged when the separate ASPIRE and ISA contracts were entered into. HM Revenue and Customs needs to integrate its operating environments to realise the benefits of the merger. For example the desktop environments of the two former departments had significantly different software and applications. The Department's Strategic Integrated Desktop Environment (STRIDE) project aims to provide this single operating environment enabling all services, information and applications to be available across the Department. This project is driven by the need to move both former Departments' operating environments off Microsoft NT4 platforms onto Microsoft XP platforms as the former will no longer be supported by Microsoft from December 2006. STRIDE began in December 2004 and has estimated development and implementation costs of about £170 million.

3.16 The Department's preferred option was to use the ASPIRE contract as the main contract for the provision of IT services to HMRC rather than put the two contracts out for re-competition. When the former HM Customs and Excise renegotiated its PFI contract with Fujitsu in 2003, it considered that its IT infrastructure could be connected to that of the Inland Revenue at no significant additional cost.[28] The Treasury required that any revised contract provides a better price and a lower cost of delivery than having two separate contracts over the full contract-term. A 'Memorandum of Understanding' between the Department, Capgemini and Fujitsu in April 2005 set out a collaborative approach to merging the contracts, including the setting-up of a working group to develop a detailed time and resource plan and contains a commitment from the two suppliers to ensure that value for money criteria are met.

3.17 The Office of Government and Commerce Gateway Review 2 in April 2005 reviewed an early business case for merging the two contracts, to ensure that the procurement strategy was robust and appropriate and that the project plan was realistic. It recommended clearer lines of accountability, better contingency planning to deal with the possible delay in agreeing a new contract from January 2006 and improved project management. It also recommended that the negotiations for the new enlarged contract should include an assessment of supplier strengths and weaknesses to ensure the achievement of value for money. Gateway Review 3 took place in November 2005 and assessed the recommended investment decision and the business case. Gateway Review 4 in February 2006 took place ahead of contract award and considered that the Department had achieved a good commercial deal in the circumstances. It found that the Department needed to complete the work to reset the service levels under the changed contract, implement better contract management arrangements and ensure that benefits of the contract integration are realised. In particular the Review considered that one

27 Financing Britain's Future *Review of the Revenue Departments,* Gus O'Donnell March 2004.
28 C&AG's report *Transforming the performance of HM Customs and Excise through electronic service delivery*, HC 1267, 2002-03) November 2003 para 2.23.

weakness identified at the previous Gateway Review was still present, that there was a lack of skills and a proven approach to IT programme/project management and risk management and that therefore the Department could improve its management of its IT contracts. In response the Department is reviewing its contract management approach so that it is more proactive in extracting the best supplier performance from the ASPIRE contract. The OGC Gateway 5 review took place in May 2006 to evaluate whether ASPIRE is delivering the benefits identified in the original business case and how well the contract is responding to changing circumstances.

3.18 Having merged the two contracts the Department will need to manage certain risks:

- that the merged contract delivers the benefits from the earlier investment in the PFI contract, and that it can track the benefits of the changed contract.[29]
- ensuring effective competition when the new combined contract comes to an end. The combined contract will make the ASPIRE contract even larger than originally envisaged which makes the re-competition and the ASPIRE exit clauses in ten years time even more important. The size of the contract may be a barrier to effective competition.
- Having reliable performance management data for the changed ASPIRE contract.
- Ensuring that the Department has in place robust contract and IT project management arrangements. This should address the areas for improvement identified by successive Gateway Reviews to extract the best value for money from the ASPIRE contract.

29 Committee of Public Accounts 24th Report 2003-04 ,June 2004, *Transforming the performance of HM Customs and Excise through electronic service delivery*.

PART FOUR
Lessons from ASPIRE

This part of the report summarises the main lessons from ASPIRE. It draws together the various strands of good practice that the report has identified from the procurement, transition and early performance of the contract.

4.1 Across government there are a large number of major outsourcing contracts.[30] As these contracts reach the end of their first-term, departments are likely to face similar competition and transition issues to those encountered by HM Revenue and Customs on ASPIRE. We have identified good practice that has arisen out of the Department's experience of ASPIRE that should help other government departments in re-competing their IT contracts and in managing any transition to a new partner (Appendix 6).

4.2 Departments will need to establish and manage good relationships between bidders, incumbent suppliers and the new supplier. This is important to ensure effective competition, a smooth transfer of knowledge and people from the incumbent to the new supplier and that value for money is achieved. Adopting this good practice should result in financial savings from better contracts, reduced transition costs and reduced risk of service disruption. The following five sections seek to draw out the main issues from ASPIRE and identify best practice that has been largely used by the Department. These have been developed with the Department and will be further developed by NAO and the Office of Government Commerce to provide guidance to departments facing a similar situation. The main lessons and good practice cover:

1. Preparing for the end of existing contracts
2. Aligning the new contract to business needs
3. Creating competition
4. Managing the transition
5. Maintaining service delivery during the transition

30 HM Treasury's PFI signed project list notes there are around 540 Private Finance Initiative (PFI) contracts with a total capital value of almost £40 billion.

1 Preparing for the end of existing contracts

a ASPIRE provides some important lessons about making a market and deciding on the most appropriate commercial strategies to provide sufficient incentives to encourage suppliers to bid when there appears to be a strong incumbent supplier, on progressing on-going IT projects and the importance of maintaining good working relations between incoming and outgoing suppliers.

b Start the work early to lay the ground for any transfer after competition, for example; train staff so that they are prepared to manage the new contract; develop an appropriate set of indicators to measure the supplier's performance; review the performance of the existing contracts including the provision for the transfer of pensions obligations; undertake a stock take of existing systems to establish whether any major upgrades are needed; review existing contracts to ensure they have robust termination clauses and terms which allow disclosure of information, to enable any new incoming supplier to undertake due diligence work. The contract terms should also be clear on intellectual property rights of existing systems.

c Effective competition, professional procurement and contract flexibility increase the chance that the contract meets the Department's IT requirements.

d To avoid IT project delays it is also important not to have too many ongoing business-crucial IT projects underway which a new supplier may have to take over. A new supplier's capacity may be stretched if there is a significant amount of work to progress with deadlines for completion early in the life of the new contract.

2 Aligning the new contract to business needs

a Departments need to be aware of the possibility of likely future machinery of government changes and include in the contracts sufficient flexibility to deal with change. This may involve some horizon scanning.

b Review existing contracts to draw lessons and reflect these in the new contract together with latest guidance, for example on mechanisms to assess value for money and incentives, continuous improvement and efficiency, and profit sharing and allowance for use of specialist subcontractors.

c Contracts for the provision of major IT systems should ensure that systems are kept up-to-date, which should be easier to transfer from one supplier to another. Deciding to change suppliers and upgrade major IT systems at the same time may appear to provide the Department with a better value than renegotiating an upgrade with the existing supplier in a non-competitive environment. However, it does increase the risk of delay, additional costs or system failure as the new supplier will not be in as strong a position as the existing supplier to achieve the upgrade. Therefore it is important that the Department reviews plans of any incoming supplier to ensure they are feasible. It must also ensure the contract has provisions to recover any additional costs caused by the failure of the new supplier to deliver.

d When changing suppliers, it is crucial to secure the co-operation between the incumbent and the new supplier. An incumbent who has bid for the new contract unsuccessfully may not wish to assist the transfer to the new supplier, even where departments have built up good relationships with suppliers during the course of a partnership. Therefore they must have effective exit clauses which bind the incumbent to cooperate during the transition period to mitigate the risks to service delivery.

3 Creating competition

a The best way to get value for money is to secure and maintain competition during the procurement. But in bidding for a major IT contract a supplier is likely to incur substantial costs and therefore will carefully weigh up the prospects of winning the contract and the opportunity costs of bidding.

b It is the usual practice when purchasing goods and services for the bidders to meet their own costs and to pay the costs involved in taking over the position from the previous supplier. It is not usual practice for the purchaser to create the competition by contributing to firms' costs of bidding, paying the winners' costs in taking over from the existing supplier, discounting the transition costs for the purposes of comparing bids and paying the incumbent supplier to effect the transfer. The payment of such costs is not unknown, and the Committee of Public Accounts outlined the circumstances in which this could be advantageous namely to avoid such costs being incorporated, with a mark up, in higher charges, and to encourage bids.[31]

c There needs to be a clear justification for using incentives to encourage competition. The market may consider that bidding against a strong incumbent is not worthwhile as there would not be an equal starting position. The bid costs of new bidders may be higher than for an incumbent which has already developed a good understanding of the Department's business. In addition, for second generation outsourcing, there will be additional costs incurred by non-incumbents in taking over existing products and services. Therefore potential bidders may be deterred from bidding against a well-established incumbent. This emphasises the importance of having a dialogue with the market to establish the barriers to bidding and how these might be overcome.

d In these circumstances, to achieve an effective competition, departments may need to consider offering incentives to encourage non-incumbent suppliers to bid or introduce other measures into the procurement process which will help to level the playing field. These incentives might include:

- adjusting the evaluation of bids to allow non-incumbents to display their IT capabilities;
- disregarding transition costs in the evaluations of bids;
- disregarding transition costs in the bid evaluation and negotiating a fixed or capped budget for transition costs to maintain competitive tension; and
- disregarding transition costs in the bid evaluation and paying a share of these costs.

e All these measures will incur additional costs for departments. Departments must decide therefore whether any, and if so which, of these will be sufficient to induce the market to bid. Departments should test the market before committing themselves to funding costs; suppliers may be willing to bid even without financial incentives. Any such incentives must have a strong link with improving value for money and must be tightly controlled.

f Having obtained bids, departments need to undertake sensitivity analysis to forecast the likely range of final contract costs. Such analysis should be used to assess the likely profit margins and profit levels of potential suppliers over the lifetime of the contract and whether the Department is getting value for money from the deal.

31 Committee of Public Accounts Report, *London Underground Public Private Partnerships*, HC 446, March 2005.

4 Managing the transition

a Now that the public sector has demonstrated it is not locked in to retaining incumbent suppliers for this size of contract, the amount of transition costs departments pay should reduce and such payments would not be appropriate in all future contracts involving an incumbent supplier. If departments decide to pay transition costs to incoming suppliers, it is important that departments retain control over the amount they pay and maintain some degree of competitive tension. They need to have a clear estimate of likely costs and transparent criteria for assessing and paying them in a system that is not overly burdensome to administer. For example:

- Estimates of transition costs should include those costs incurred by the incoming supplier in preparing to run the new contract; those of outgoing suppliers and the department's staff costs. During the procurement stage, departments need to have a clear estimate of transition costs. There should be no presumption by a bidder that any extra transition costs incurred by any incoming supplier will be fully or partially repaid.
- Before any new contract is signed, departments and suppliers must be clear about what will be payable under transition costs and there should be a transparent system for assessing and paying them. To make the system easier to administer, transition costs should be linked to the achievement of transition milestones.
- Departments should also question whether it is reasonable for incoming suppliers to receive a profit margin on reimbursed transition costs but realise that denying the margin can affect the quality of the expertise applied to the account.

5 Maintaining service delivery during the transition

a There is a risk that ongoing projects will suffer delays and cost increases when changing supplier – particularly if the new supplier has to work with plans agreed between the department and previous supplier. Departments and suppliers should therefore take the opportunity to undertake a health-check of ongoing projects and may need to re-evaluate project plans. Departments should also get an early view of a new supplier's performance (and changes in costs for existing projects), so that any issues which would affect service delivery or costs can be addressed.

b Departments should develop and test contingency plans to ensure service delivery and project progress can be maintained in case part or all of the transfer is delayed. When considering the length of the transfer, departments need to strike a balance between incurring additional transfer costs and the risk that the transfer might not be fully completed.

c A high level of staff transfer is important in maintaining project momentum. However changing IT suppliers and contracts will involve new relationships and new ways of working. During the transition period, departments will need to make additional effort to manage the relationships between the incoming and outgoing suppliers. Departments will also need to agree with the incoming supplier revised project risks, costs, timescales and deliverables.

d While there are advantages in keeping existing projects under the terms and conditions of the previous contract, departments should closely monitor costs charged by the new supplier to ensure that value for money is not put at risk. Departments should review cost implications arising from changes or delays which are the responsibility of the supplier to ensure additional costs incurred are not transferred to other parts of the contract.

e To manage the risks of changing suppliers, departments need strong governance arrangements and good management information to keep the supplier on course for delivery, or to enable them to make an informed decision to move milestones and plans. Departments should also require suppliers to:

- use software products and third party suppliers that are tried and tested;
- plan for an incremental phased delivery of new IT projects or major changes to existing systems rather than a big bang solution;
- allow sufficient time for testing of new IT systems before they are launched; and
- provide a mechanism to enable the incumbent and new suppliers to share plans and information during transition.

APPENDIX ONE

Study scope and methodology

The study objective was to assess HM Revenue and Customs performance in three stages of ASPIRE: the procurement, the transition and the first year of the new contract and to draw wider lessons for government department and agencies facing similar situations. We used an issue analysis approach to design the scope of the examination and the nature of the evidence required.

Semi-structured interviews and fieldwork visits

1 We interviewed staff in HM Revenue and Customs with responsibility for the procurement, transition and contract management stages of ASPIRE as well as other stakeholders, including the Office of Government Commerce and Partnerships UK.

2 We also interviewed the private sector firms involved in ASPIRE including the original suppliers (EDS and Accenture), and the winning bidders (Capgemini and Fujitsu) to get their perspectives on the ASPIRE procurement, transition and contract management stages.

Documentary review

3 We reviewed a range of documentary evidence from ASPIRE to analyse and establish the basis for key decisions taken by HM Revenue and Customs. We analysed the Department's financial and management information on the costs of procurement and the transition and the first year of the contract and the suppliers' performance against key performance indicators.

Comparators

4 We compared procurement costs and profit margins with other contracts. We also analysed the Office of Government Commerce Gateway Reviews undertaken on ASPIRE and evaluated advice and documentation issued by other government departments including HM Treasury and the Office of Government Commerce.

Analysis of the effects of ASPIRE on service delivery and business-critical projects

5 We reviewed key HM Revenue and Customs IT projects to explore the impact of ASPIRE on service delivery and draw out the lessons learned from managing IT projects when there is a change of supplier. The projects were selected because the change of supplier happened during the course of the project and HM Revenue and Customs consider them as 'business-critical'. For each example we reviewed key documents and interviewed project managers and directors of the individual projects.

Comparisons with other transitions

6 We commissioned PricewaterhouseCoopers to draw out lessons from organisations that have faced major supplier transitions similar to ASPIRE. The organisations covered included those from the public and private sectors, both in the UK and overseas. The examples highlighted some common features, such as the importance of effective communication with staff who are available for transfer to any new supplier, which we used to assess the Department's and suppliers' approach to, and performance during, the transition.

Financial model review

7 We commissioned PricewaterhouseCoopers to undertake work on the financial model used by HM Revenue and Customs in ASPIRE to assess whether the processes used by the Department to test the financial models during the procurement stage were robust and whether the Department were using the models to manage the contract changes effectively. This involved interviews with key staff involved in financial evaluation, examination and review of documentation from the model reviews and the events and costs that triggered the changes.

APPENDIX TWO

Recommendations from the Committee of Public Accounts

The Committee of Public Accounts has in the past made a number of recommendations covering HM Revenue and Customs IT contracts.

PAC Report	PAC Recommendations	Has this been applied in ASPIRE?
Inland Revenue/EDS Strategic Partnership: The award of New Work (28th report 1999-2000)	The Department should keep its IT strategy up to date and ensure the supplier's technical solutions conform to this wherever possible.	The Department revised its IT strategy in April 2005. The new strategy aims to rationalise current IT infrastructure and put in place industry standard processes and solutions.
	The Department should impose tighter control when developing applications with the contractor to ensure that objectivity is not lost in assessing proposals and controlling costs.	There is an established process for new work involving setting requirements, the supplier's proposal, the business case, approval and then pilot trials. The project must run successfully for 6 months before payments are released.
	The Department should apply the lessons from post implementation reviews of new IT developments and projects.	Since the start of the ASPIRE contract, major IT releases have been made in October 2004, April 2005, October 2005 and April 2006. After each release, ASPIRE carried out a post implementation review and the findings were provided as input to the following release. A process has been put in place to capture lessons learned and to share them more widely.
	The Department should ensure that it establishes close links with the Office of Government Commerce (OGC) to share experiences.	The Department has worked with the OGC to share good practice from ASPIRE. The OGC has included ASPIRE as a case study in the latest version of its procurement guidance.
	The Department should extend benchmarking work to assess the competitiveness of supplier charges to cover more of the contract costs on a regular basis.	Ad-hoc benchmarking and market-testing is underway under ASPIRE. A comprehensive two-year rolling benchmarking programme is expected to begin in July 2006.
	The Department should reconsider the value for money it obtains through the equal split of procurement discount savings made by EDS buying power.	Under ASPIRE, procurement discount sharing arrangements are in place. The contract states that any procurement by the supplier above £50,000 will be benchmarked against a third-party price. Using this benchmark, the Department will retain 80% of the difference between the actual cost to the supplier and the third-party comparator price where the supplier has purchased items below the third-party comparator price and 50% where the supplier has purchased items above the third-party price.

PAC Report *continued*	PAC Recommendations *continued*	Has this been applied in ASPIRE? *continued*
	The Department should monitor the delivery on other contracts held by the supplier, to identify potential risks which might affect services provided under the partnership.	As part of the evaluation, the Department obtained references for each bidder from other organisations.
	The Department should reassess the risk of unplanned departures from its contract management team and sharpen succession planning for specialists.	Of fifteen Departmental staff involved in the procurement stage, only one remained in place for the contract management as the Department suffered key departures soon after the award of the new contract, including that of the Senior Responsible Owner.
	In view of the importance of securing an open competition, the Department will need to ensure that proposals for new systems do not unduly limit its future choice of strategic partner.	The Department achieved competition by encouraging the industry to bid for the contract, through the use of incentives such as paying unique transition costs and excluding these from the bidder evaluation.
NIRS2 Contract Extension (38th Report 2001-02)	The barriers to competition when the Department's contracts come to an end may be too great. In the absence of competition the Department will need to ensure that the methodologies used to estimate and benchmark bid proposals are rigorous.	
	The Department should explore how to build additional flexibility into future contracts, for example to cope with legislative changes.	HM Revenue and Customs believes that the ASPIRE contract is flexible enough to deal with major change, but this needs to be proved in practice, particularly with the merger of the PFI contract held by the former HM Customs and Excise with ASPIRE.
Managing the Relationship to secure a Successful Partnership in PFI projects (42nd Report 2001-02)	Staff continuity between the procurement and the subsequent management of the contract is desirable. Where this is not possible, there should be a gradual hand-over between the staff who negotiated the deal and those who will be responsible for post-contract management to ensure continuity.	Of fifteen Departmental staff involved in the procurement stage, only one remained in place for the contract management as the Department suffered key departures soon after the award of the new contract, including that of the Senior Responsible Owner.
	Departments should ensure that mechanisms are in place to provide continued value for money over the lifetime of a deal.	The Department has some controls in place to assess value for money of the contract and is developing others.
Transforming the performance of HM Customs and Excise through electronic service delivery	The cost of the PFI contract with Fujitsu has increased from £500 million to £929 million. Retendering the contract would have given better assurance on the value for money of the revised contract, but would also have put at risk the expected benefits of the e-programme. The Department should complete a full business case for the e-programme, supported by sensitivity analyses of benefits and costs. It should specify the benefits, and formulate plans for realising them.	The Department will need to ensure that in merging the PFI contract into ASPIRE, the expected benefits from the investment of £929 million in the PFI contract amended in 2003 are fully realised.

APPENDIX THREE

Office of Government Commerce guidance for re-competitions

When drafting the original contract

- TUPE (Transfer of Undertakings (Protection of Employment)) clauses should be included in all contracts for services.
- Provisions for full sharing of any information that might give the incumbent contractor an advantage. Such information is to be provided in time to be included in any invitation to tender.
- The contractor should keep up to date the inventory of equipment passed to them at the outset of the contract, and there should be an up front agreement on who will own which pieces of equipment at contract termination.
- The level of servicing of any equipment should also be specified.
- Ownership and transfer of IT equipment and other tangible property, software and data should be made clear.

Eighteen months to four years before contract end

- Negotiate with the incumbent contractor to insert missing provisions, as listed above.
- Determine the strategy for the new contract, so it reflects future business needs. For example, consider changing the scope; all outsourcing options; risk allocation; flexibility; and partnership.

Only consider extending the existing contract when

- There was scope within the original advertisement in the OJEU for a possible extension.
- The existing supplier is performing well and is well placed to deliver business needs.
- The supplier is not over-dependant on the department.
- The market remains competitive. If there are few suppliers in a market place and an existing large contract is extended, competitiveness may be reduced.

If it is decided to go to competition

- Actively publicise intentions and manage the market's expectations to establish the conditions for a robust competition.
- Try to secure the incumbent supplier's interest in the re-competition to maximise competition and incentivise it to maintain performance levels until the expiry of the contract.

Create a level playing field against a strong incumbent

- Encourage all potential suppliers to believe the contract is winnable and are incentivised to bid. This may include senior staff actively promoting the openness of the competition; providing bidders with full information on all aspects of the work; funding transition costs and disregarding the risk of transition in the evaluation criteria; allowing payment for a de-risking as 'proof of concept' stage; providing access to all sites and allowing bidders to comment on the requirement specification.

If the contract is being tendered in the middle of a major IT project

- Negotiate an agreement for payment of additional sums to retain the incumbent's key staff for a set period to help with knowledge transfer.
- Avoid placing significant new demands on the incumbent just before the transition.

Source: Office of Government Commerce Successful Delivery Toolkit

APPENDIX FOUR

Lessons learnt from the EDS 'Eagle' contract and the Accenture NIRS2 contract

The Department identified a number of lessons from outsourcing its IT services to EDS and the PFI contract for NIRS2 with Accenture.

Lesson	Has this been applied to Aspire?
Effective contract management should ensure that the contract is operated properly and obligations are adhered to but must also provide a framework for handling issues which arise outside the contract, or which require changes.	The Department has invested time to adapt its procedures to cope with the change from an input to an output based project. The Department has recognised that its staff need a better understanding of the new contract and has initiated an education process for all staff to learn how to get the best out of ASPIRE. A separate Contract Management Team provides a source of expertise for the business. **FULLY APPLIED**
It is unlikely that a single supplier will hold all the skills to meet the Department's requirements so contracts should encourage and institutionalise co-partnering with the 'lead supplier'.	The concept of a strategic partnership with co-partnering was identified early on as the best solution to meet the Department's requirements. It provides a single supplier with overall responsibility and accountability for IT integration and gives the Department access to a range of suppliers and new technology so it is not locked into one or two large suppliers. **FULLY APPLIED**
Effective performance measurement needs base lining of current service levels. Service levels need to refer to desired business outcomes and should be based on outputs rather than inputs.	A performance measurement system is in place, providing information on the supplier's performance against targets and target margins. However these measures were rolled over from the previous contract and may not all be relevant under ASPIRE. A service improvement programme is underway which aims to improve the performance measures for monitoring the contract. **PARTIALLY APPLIED**
The contract term should be long enough to establish the benefits of the relationship and should retain some flexibility beyond the minimum term of the contract to help manage the timing of the following competition.	The ASPIRE contract is for ten years with the option for an additional eight. This should help to avoid the cliff-edge scenario under the previous contract as it provides flexibility for the Department to decide the most desirable point for re-competition. **FULLY APPLIED**
Risks should be allocated to the partner best able to manage them, but given the pace of change in IT, flexibility is also important.	The contract was designed to allocate risk on an appropriate basis and provide flexibility to bring in specialist sub-contractors. **FULLY APPLIED**
Fixed price agreements should be made (where appropriate) to incentivise supplier performance.	ASPIRE aims to incentivise the supplier by paying on the basis of outputs rather than inputs and includes discounts for increased volume but additional funding for lower volumes. The contract makes payments on the successful completion of the milestones and contains penalties for delayed delivery. **PARTIALLY APPLIED**

Lesson *continued*	**Has this been applied to Aspire?** *continued*
The contract should ensure that there are incentives for the supplier to get the best price when purchasing capital assets and that the Department should share any savings made.	The ASPIRE contract contains clauses whereby the savings obtained by the supplier would be shared between the supplier and the Department. The contract states that any procurement by the supplier above £50,000 will be benchmarked against a third-party price. Using this benchmark, the Department will retain 80% of the difference between the actual cost to the supplier and the third-party comparator price where the supplier has purchased items below the third-party comparator price and 50% where the supplier has purchased items above the third-party price. **FULLY APPLIED**
For contracts where outputs may be usefully applied across other Departments, the ownership of the intellectual property rights should be retained by the Department.	The ownership of intellectual property rights was maintained by the Department as part of the ASPIRE contract. This is the same as for the old contract with EDS, but different from the NIRS2 PFI contract with Accenture, where the Department had to buy the rights to use from Accenture at the end of the contract. **FULLY APPLIED**
The end of the contracts should be planned at the outset to ensure that if there is a change of supplier the incumbent supplier will be bound to provide appropriate levels of support and assistance to any new supplier.	The Department negotiated amendments with suppliers to the previous contracts before their end. Under ASPIRE exit arrangements are stronger, but may need re-negotiating over the course of the contract. **FULLY APPLIED**
The Department needs to maintain its own pool of IT staff to act as an 'intelligent customer'; to be able to check and evaluate supplier proposals and act as an intermediary between the Department's business groups and the supplier.	The Department has enough IT expertise to check and evaluate the supplier's proposals. It is however seeking to reduce the ratio of its IT staff to the supplier team from 30:70 to nearer 20:80 to reduce running costs. **FULLY APPLIED**
Relationships between Department and supplier should be treated as a partnership. The principles of this rest on joint responsibility and understanding. For example, continuity of staff across the procurement, transition and contract management stages helps to build relationships and trust.	The ability to act as a partner was a key criteria of the bid evaluation, and partly because of the high level of staff transfer from the old to new supplier, sound relationships have been formed. The contract itself stipulated the names of certain key supplier management personnel to remain on ASPIRE for a length of the time after the contract started. However continuity on both sides is important. Of fifteen Departmental staff involved in the procurement stage, only one remained in place for the contract management as the Department suffered key departures soon after the award of the new contract, including that of the Senior Responsible Owner. **PARTIALLY APPLIED**

APPENDIX FIVE

The risks of transition and the early stages of ASPIRE

Main risks in the transition phase and the Department's response

Main risks	The Department's response
Escalation of transition costs	■ The Department set a budget of 10-15 per cent of the contract's first year value (around £50 million) for unique transition costs (those costs identified by the supplier and agreed with the Department which would not have been incurred had the existing suppliers continued to provide all or part of the IT). ■ Costs were generally well controlled and came in around budget, although the Department and the new supplier did not agree what would qualify as a unique transition cost until the transition had started, so valuable resources were taken up during transition negotiating whether a cost was unique or not.
Lack of or ineffective co-operation between exiting supplier, new supplier and Department during the changeover	■ The cooperation of the incumbent suppliers and the positive working relationship that was developed by the Department through day-to-day collaboration in the existing Eagle and NIRS2 contracts and in running the procurement. Exit clauses the Department negotiated with EDS in 2002 provided a certain level of support and information to any incoming supplier. In addition the outgoing suppliers wanted to exit on good terms.
Ongoing service delivery would be disrupted by the transition and key projects spanning the transition would be disrupted or delayed	■ The transition was generally well managed by the Department, with no major disruptions to services. ■ During transition, the incumbent suppliers delivered scheduled IT releases and worked with the incoming suppliers to develop project plans. The incoming suppliers reviewed IT project progress to date and estimated the time and cost needed to complete the projects. ■ The high volume of change projects during transition put a strain on both Departmental and supplier capacity during the early stages of the new contract.
Not successfully completing the transition on time so the new supplier was not in a position to run the new contract from day one	■ The transition period allowed the incoming supplier sufficient time to prepare to run IT service from the start of the new contract. To achieve this, it acquired sufficient knowledge and understanding of HM Revenue and Customs' business and IT environment, either through work-shadowing existing staff or through arranging staff transfer, and ensured that most existing sub-contractors were retained.

Risks at the beginning of a new contract with a new supplier

Main risks	The Department's response
Cost escalation without compensating increases in benefits	■ The Department has mechanisms to control costs and deliver benefits. It intends to carry out an overall assessment of supplier performance in late 2006.
Not gaining a sufficient share of the benefits and profits the contractor obtains from the strategic partnership over the course of the contract	■ ASPIRE contains agreed governance processes to identify the Department's share of benefits realised from innovation, identifying savings and benefits generated. ■ The contract transfers performance risk to the supplier for operational services, and incremental payments for software development are based on successful delivery.
The Supplier and Department not having the capacity, resource and skills to manage and deliver the IT requirements of a larger single contract	■ Needs may change for new skills and technology. Effective management of sub-contractors and co-partners can alleviate this risk. Under Capgemini plans, the Department will be involved in the monitoring and management of sub-contractor performance.
Opportunities for innovation not realised	■ Requirements may change over the term of the contract, particularly with regards to the recent merger with HM Customs & Excise. The contract allows the Department to require the supplier to engage particular 'co-partners' where new skills or technologies are needed, benchmarking suggests the marketplace may offer an economic advantage or where volume increases or peaks of resource requirement cannot be supplied by the Supplier's internal resources ■ Technology-enabled change and innovation was a key part of the evaluation of the bids.
Insufficient management of sub-contractor performance	■ The Department has a copy of the sub-contract and the supplier has confirmed that there is a full flow down of terms and conditions.
Early break of contract	■ The Department has built contingency measures into the contract, requiring the supplier to deliver services up to the point of expiry or termination, co-operate with the Department and any successor supplier to ensure smooth continuation of services, and make provisions for the assignment of rights relating to the project. ■ The contract also contains clauses on asset treatment and staff treatment.
Supplier failure	■ The contract includes a guarantee that Capgemini's parent company would intervene in case of supplier failure. Total claims are limited and related to operational and project charges.
The merger with Customs and its separate IT contract with Fujitsu may lead to cost escalation, delays to critical projects and delays in benefits coming on stream	■ The two contracts have not yet been merged. Negotiations are ongoing. The Department has selected a preferred option to bring together the two contracts.

Source: National Audit Office

APPENDIX SIX

Lessons from ASPIRE

Managing relationships throughout the process

Establish and build relationships with potential and incumbent suppliers	Review the balance between in-house and supplier IT support to ensure business efficiency	Encourage collaboration between the incumbent and new suppliers during transition

Being prepared for the end of the existing contract

- Review performance of existing contract/contractor
- Stocktake existing IT systems/assets/contracts and prioritise costs and benefits of upgrading IT systems
- Implement a safety zone to avoid having too many IT projects/business change programmes ongoing at the end of the contract
- Scan the horizon to identify implications of potential machinery of government changes
- Review existing contracts to ensure they have robust termination clauses
- Fully evaluate contract replacement options
- Clear commercial strategies with external stakeholders

Aligning the contract to business needs

- Review contract and supplier performance to draw lessons for the new contact
- Include up-to-date mechanisms to assess value for money
- Allow for contract review at fixed points and have flexibility around re-let date
- Ensure the contract is flexible enough to deal with business and machinery of government changes
- Ensure the contract allows for use of sub-contractors
- Underpin productivity incentives and profit sharing in line with open book and use financial models for the competition that are baselined in the contract
- Consider the principles of risk and reward sharing

Creating competition

- Listen and develop a strategy to respond to the market to foster competition
- Demonstrate the 'Unique Selling Point' of your competition
- Consider incentives to level playing field and encourage competition
- Minimise the burden on bidders and ensure timescales are adhered to
- Evaluate using a range of criteria that relect business and financial needs
- Maintain competitive pressure during negotiations

Source: National Audit Office

Ensure a visible process so employees can decide if they want to transfer or remain with the incumbent

Engage with business areas and prepare staff for the transition and the new contract

Managing the transition

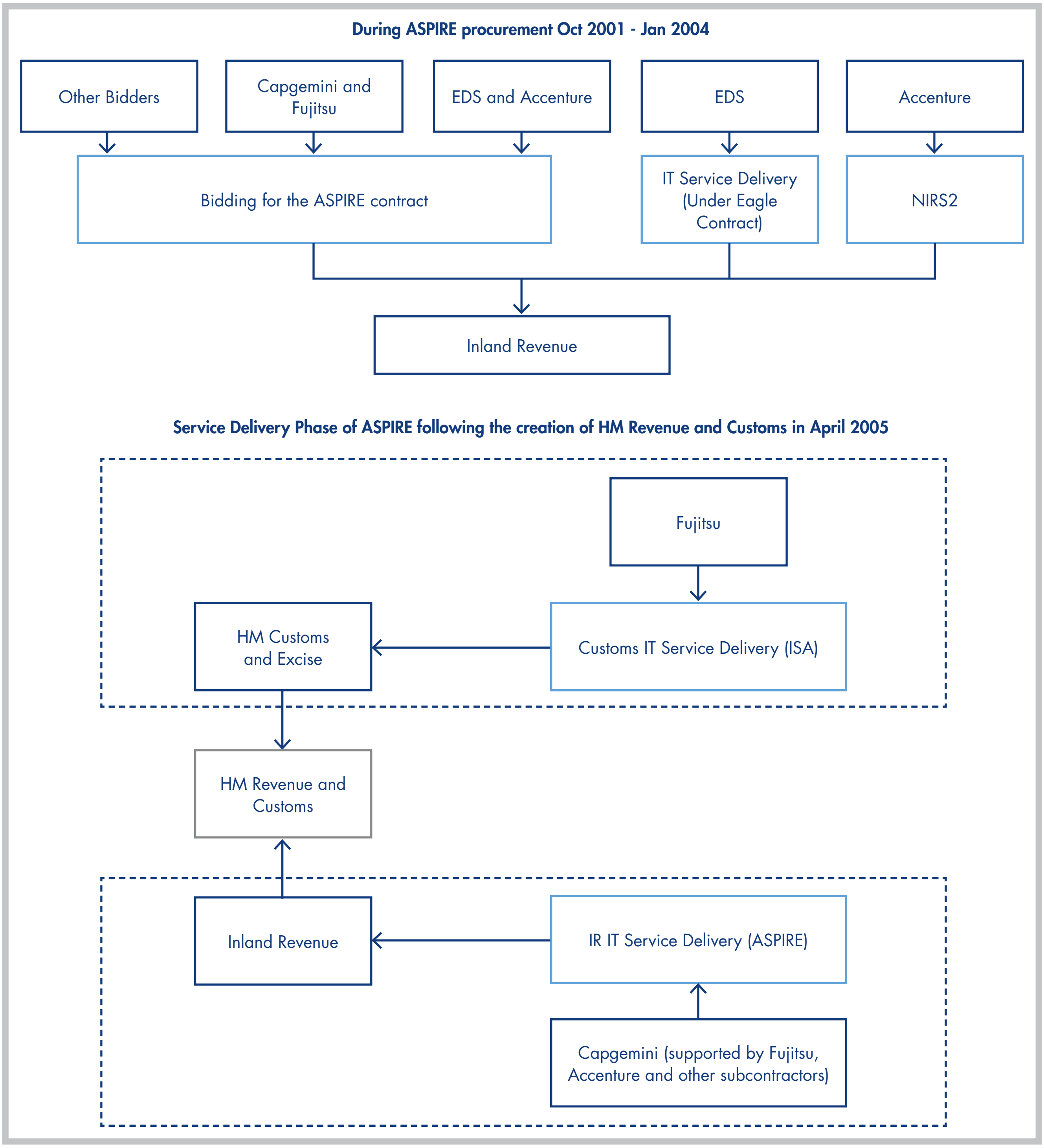
- Develop an integrated transition plan specifying milestones, deliverables and responsibilities as early as possible
- Develop and test contingency plans
- Ensure that the length of transition is fit for purpose
- Manage the transfer of third-party contracts, including having a strategy for those due for renewal during transition and replacing those that don't transfer
- Estimate and control the costs of transition
- Provide additional space for the incoming supplier during transition

Maintaining service delivery

- Compile an inventory of projects and examine their status and earned value
- Carefully manage the risks to loss of service when transferring IT systems
- Maintain staff continuity by getting high levels of staff transfer and backfill any vacancies during transition
- Healthcheck ongoing projects with the new supplier and re-evaluate plans if necessary
- Balance the needs of the new supplier with those of the incumbent and protect the live service
- Ensure all new terms of reference apply to transferred projects
- Get an early view of the new suppliers performance

APPENDIX SEVEN

Diagram of the interrelation of the main parties in ASPIRE



APPENDIX EIGHT

The NIRS2 transition

Background

The Inland Revenue had a ten year PFI contract with Accenture from 1995 for the provision of the National Insurance Recording System (NIRS2). The NIRS2 system holds over 70 million National Insurance records, processes 50 million end-of-year employee returns, feeds data to other tax systems, supports the accuracy of National Insurance data, and calculates rebates to the pensions industry (around £3 billion a year).

The Committee of Public Accounts' report on the "Contract to Develop and Update the Replacement National Insurance Recording System" (46th Report 1997-98) highlighted concerns about delays in implementing the system, which was large and complex, and that the low winning bid may have signalled that the bidder did not appreciate the complexity of the project. The Committee recommended that the Department should ensure it fully understood the impact of any delay on its business; have contingency plans including fallback positions in place; and contracts which provided adequate compensation in the event of delays.

The Committee of Public Accounts' report on "NIRS2 Contract extension" (38th Report 2001-02) highlighted that the contract extension the Inland Revenue had negotiated with Accenture was generous for a non-competitive contract as the contractor had outperformed its productivity target by a wide margin. This raised questions about how rigorous the original estimates and benchmarking were. The Committee also considered that the Inland Revenue would face a challenge in 2004 as the barriers to competition may be too great in terms of learning and costs for such a large and complex system. It also highlighted the benefits of incentivisation of performance, transparency, minimising the risk of disputes, replicating lessons learnt on earlier projects and sensible allocation of risks.

Upgrading NIRS2

The NIRS2 system needed to be re-platformed (which involved providing new hardware, operating system and database to support NIRS2) as it was based on old technology with a limited shelf-life and was running out of support products. The Department considered that there would be limited risk in deferring the re-platforming to enable it to get better value for money and some creative proposals by including it in the ASPIRE competition. Each bidder had different plans to re-platform NIRS2. The Department was initially surprised that Capgemini proposed a "big bang" approach (Accenture, the incumbent supplier, proposed a phased approach). Changing contractor required the movement of NIRS2 systems from equipment that was hosted by Accenture to Fujitsu to enable the new suppliers to take over the day-to-day operation of the system. The migration of NIRS2 represented a significant challenge due to the system's complexity and the need to update both hardware and system software. The original timetable was for the migration to take place over the Christmas 2004 period to minimise the impact on customers.

The re-platforming was delayed

Capgemini and Fujitsu encountered major problems in the system build which delayed the project's progress and testing programme. Because of these problems, the Department and suppliers made a joint decision in November 2004 to postpone the re-platforming. Following negotiations with Accenture, the existing equipment used by Accenture, which until then had been unavailable, was used, allowing a phased approach to the re-platforming during the May, July and August 2005 bank holiday weekends. Accenture, the previous contractor since 1995, has been retained as a subcontractor under ASPIRE for the duration of the ASPIRE contract. The cost of completing the migration in the deferred timescale was £9.9 million. Capgemini has paid £7.9 million and the Department £2 million. The Department did not accept liability but considered it was not worthwhile to establish all the causes of failure and attribute them to any party, as the additional costs were within its original estimate of £16.2 million for re-platforming. Although the delays did not affect service delivery, the system was implemented at the end of August 2005 but was not fully operational until November 2005, and since then the system has performed at improved levels.