



National Audit Office

Central government's management of service contracts

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SUMMARY

1 In 2007-08 central government spent over £12 billion on service contracts primarily in the areas of information and communications technology, facilities management and business process outsourcing. As well as providing routine support services, service contractors also deliver high profile, business-critical services, such as the IT system supporting the payment of social security benefits, the provision of security at court buildings, and the production and delivery of passports. Service contractors also regularly handle large amounts of personal and security information.

2 The organisations we surveyed estimated that they spent on average the equivalent of two per cent of annual contract expenditure on managing their service contracts. Applying this average indicates that central government spent an estimated £240 million in 2007-08 on managing service contracts. The delivery of

public services, protection against service failure and achievement of value for money are all dependent on effective contract management. The consequences of service failure can be serious and we have reported previously on the difficulties the Rural Payments Agency and its contractors experienced in implementing the IT systems for administering the single payment scheme for farmers. The more recent delays in the marking of SATS tests have further highlighted the important role contractors play and the impact service failure can have. At the same time, this report identifies examples of good practice contract management, such as the Department for Work and Pensions' contract with BT to provide telecommunications services where there was good senior management engagement with the supplier. There has also been some effective joint working between government organisations and suppliers to improve services and reduce costs.

3 This report examines how well central government organisations are managing their service contracts, assessed against the good practice framework for contract management which we developed at the outset of our work. We also examined the effectiveness of the Office of Government Commerce in supporting central government to improve contract management. The methods we used are set out in Appendix 1.

4 Our work focused on contracts for information and communications technology, facilities management and business process outsourcing, where the contract had been signed and the service was up and running. Contract management is especially important where suppliers are engaged to provide services over a long period of time and customers need to ensure that service levels and value for money are maintained over the duration of the contract. The contracts we covered included both those procured under the Private Finance Initiative (PFI) (19 per cent of the contracts in our survey) and non-PFI contracts (81 per cent of the contracts in our survey). While there are issues which may arise in relation to PFI contracts which involve an added degree of complexity, for example in their arrangements for refinancing, our work focused on the core areas of contract management which are common to both types of contract. Our findings and recommendations are therefore applicable to all long-term contracts and support messages from previous National Audit Office reports on PFI contracts.

Our key findings

5 Central government organisations are not always according contract management the priority it deserves. There is often no one individual with overall responsibility for contract management across an organisation, though our survey indicated that at the top of organisations there is a fairly good understanding of the importance of effective contract management. For example, the Permanent Secretary at the Department for Work and Pensions is actively involved in the management of major suppliers. There was no documented plan for managing individual contracts in over a quarter of cases and where plans did exist, supplier input was limited.

6 Central government organisations do not always allocate appropriate skills and resources to the management of their service contracts. Twenty-seven per cent of commercial directors/heads of procurement rated the level of resources allocated to contract management as poor, and resources were

stretched on a number of the contracts that we assessed. One contract manager, for example, was managing two other service contracts as well as the £29 million a year contract for the provision of court security. Most contract managers have three or more years experience of managing large contracts and have attended some relevant training, though there is a lack of structured training programmes and few contract managers hold any formal commercial qualification (for example, membership of the Chartered Institute of Purchasing and Supply).

7 There are weaknesses in key performance indicators and limited use of financial incentives to drive supplier performance. By and large, organisations collect performance information and discuss supplier performance regularly, though one contract we assessed (the Foreign and Commonwealth Office's £23 million a year contract for travel services) had no formal performance measures (service level agreements/key performance indicators). In addition, key performance indicators are not always reviewed and updated on a regular basis to keep pace with changing business requirements. Where financial incentives were in place, 38 per cent of contract managers did not always invoke payment deductions in the event that supplier performance fell below the specified standard.

8 Despite the critical nature of the contracts in our survey, many did not have in place some or all elements of good practice risk management processes. For example, 37 per cent of contracts did not have a risk register and 56 per cent did not have a contingency plan in case of supplier failure. On one of the contracts we assessed (the Driving Standards Agency's contract for driving theory tests), risk management processes are being reviewed following the loss within the contractor's data centre of a computer hard disk drive containing personal information.

9 Value for money testing can result in significant savings but the extent to which central government tests the value for money of ongoing services and contract changes is variable. For example, a benchmarking exercise resulted in the Home Office saving £17 million a year on its IT contract, around 20 per cent of the total annual contract expenditure. In terms of supplier development, central government organisations are regularly working with suppliers to secure performance improvements, although much of this activity is uncoordinated with only 53 per cent of contract managers having a formal plan for supplier development.

10 In general both central government organisations and their suppliers are positive about working relationships, though less than half of organisations had implemented a supplier relationship management programme despite what appear to be clear benefits.

Eighty-three per cent of suppliers involved in such a programme considered it had helped to improve the relationship with their customer. Ways in which day-to-day working relationships might be improved include defining more clearly the expected behaviours of both parties throughout the duration of the contract.

11 The Office of Government Commerce can do more to support central government organisations to improve contract management. A key theme from the Procurement Capability Reviews is that there is considerable scope for government departments to improve contract management, with in particular a shortfall in contract management skills and resources. The Office of Government Commerce is in the process of improving its guidance and developing training on contract management, and it is also collecting and disseminating information on supplier performance to help central government manage major suppliers, though to date this exercise has not extended much beyond the IT sector.

Our value for money conclusion

12 While there are examples of good practice, central government's management of service contracts is not consistently delivering value for money. Nearly all the organisations we surveyed thought that value for money could be improved through better contract management, in terms of more or better services, and/or lower costs. Based on the survey, we estimate that better contract management could potentially generate efficiency savings of between £160 million and £290 million a year across the organisations we surveyed through reduced contract expenditure, and this may well be a conservative figure as it is based on estimates the organisations themselves provided in our survey. As well as financial savings, better contract management could bring improvements in the quantity and/or quality of services, the avoidance of service failure, and better management of risk.

Our recommendations

13 Our recommendations below set out the actions we consider necessary to secure improvements in contract management and thereby better value for money. The changes required to implement the recommendations primarily involve a more effective use of existing resources by central government organisations and the Office of Government Commerce, although some changes would result in some additional costs.

For central government organisations

14 To achieve better value for money and reduce contract risk, central government needs to apply good practice contract management more consistently. There should be an expectation of improvement throughout the duration of a contract and central government organisations should exploit opportunities to work with suppliers to get more out of their contracts. Organisations should benchmark their arrangements for contract management against our good practice framework and, in light of the results, put in place an improvement plan. Organisations should pay particular attention to the following areas.

a Raising the profile of contract management

Service contracts are essential for the delivery of central government's objectives but contract management is not always accorded the priority it deserves.

To raise the profile of contract management central government organisations should include in their annual report details of their most important (taking account of contract risk and expenditure) service contracts, and highlight the actions taken to improve value for money and reduce risk.

b Ownership of contract management policies and strategy

Less than half the organisations surveyed had an individual with overall responsibility for contract management.

Central government organisations should assign ownership of contract management issues across their organisation to a single individual (for example, the commercial director/head of procurement) who has a clear remit to improve contract management and the authority to deliver change. Among other things, the individual should be responsible for ensuring that contract management plans and appropriate governance arrangements are in place for all major contracts.

- c** Establishing effective management arrangements at the outset of each contract

For some of the contracts we assessed it had taken several years to reach the point where the contract was being managed well in terms of, for example, putting in place sufficient resources and appropriate performance measures. Central government organisations should integrate the establishment of good contract management arrangements into the final stages of the procurement process, and before approving the award of major service contracts senior managers should review these arrangements and sign them off as fit for purpose.

- d** Resourcing of contract management

More than a quarter of commercial directors/ heads of procurement rated the level of resources allocated to contract management as poor, and resources were stretched on a number of the contracts we assessed. In deciding how to resource their contract management activities, central government organisations should assess the value for money opportunities and level of risk associated with individual contracts across their portfolio of service contracts, drawing on the guidance in our good practice framework. This assessment will help organisations determine whether the resources they have are allocated to best effect, and whether they need to improve the quantity and/or quality of resources to exploit opportunities for value for money gains and to manage risk effectively.

- e** Performance measurement

A number of contracts had inadequate key performance indicators to measure and drive the performance of suppliers. Central government organisations should review key performance indicators at least annually and update them as necessary to reflect changing requirements.

- f** Financial penalties for poor performance

Over a third of contract managers did not always invoke payment deductions for under-performance by a supplier when the contract entitled them to do so. Where mechanisms for financial penalties are in place, central government organisations should apply them rather than forgoing revenue entitlements for fear of jeopardising relations with the supplier.

- g** Value for money testing

Value for money testing is particularly important where contracts run for a long period for time, but central government organisations do not routinely test their service contracts. Organisations should regularly test the value for money of both ongoing services and any major additions to the contract through, for example, price benchmarking or market testing. Where contracts do not include provision for value for money testing, organisations should negotiate such clauses at the earliest opportunity.

- h** Risk management

Despite the critical nature of many service contracts, involving for example the handling of personal information, good practice risk management practices are not being consistently applied. Central government organisations should review the risks associated with their major service contracts. Risks should be identified in a risk register and assigned an owner, and there should be regular reporting of business-critical risks at Board level. Mitigating actions should be planned and implemented, and each major service contract should have a contingency plan in case of supplier failure.

For the Office of Government Commerce

15 Responsibility for managing service contracts clearly rests with central government organisations, but the Office of Government Commerce has a role to play in, for example, providing guidance and supporting the development of training programmes. It has begun to provide more support to central government to improve contract management. In doing so, it should pay particular attention to the following areas.

- a** **Limited guidance is available on contract management.** In enhancing the material it provides, the Office of Government Commerce should build on the good practice framework we have developed to provide contract managers with comprehensive and easily accessible guidance.
- b** **Central government organisations identified a need for better training for their contract managers.** The Office of Government Commerce should support the development of training which complements existing provision and which draws on good practice from both the public and private sectors (for example, the modular programme developed by Lloyds TSB highlighted in this report).

- c** **There is currently no cross-government contract management community.** In taking forward its plans to incorporate explicitly such a community within the overall Government Procurement Service structure, the Office of Government Commerce should in particular seek to embrace the large numbers of contract managers without procurement backgrounds and who sit outside central procurement functions.
- d** **The work to assist central government in monitoring and managing major suppliers has focused mainly on the IT sector.** The Office of Government Commerce should extend the approach it has adopted with the IT sector to cover other major service categories. It should collect and disseminate information on the performance of major suppliers, and work with central government and suppliers to secure performance improvements.