National Audit Office

**Report**
by the Comptroller
and Auditor General

**Cabinet Office**

# Spinning-out MyCSP as a mutual joint venture

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Cabinet Office

# Spinning-out MyCSP as a mutual joint venture

Report by the Comptroller and Auditor General

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Comptroller and Auditor General
National Audit Office

30 August 2013

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This study examines the spinning-out of MyCSP as a mutual joint venture and whether it will enable value for money to be achieved.

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This report can be found on the National Audit Office website at www.nao.org.uk/mycsp-2013

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# Key facts

**25%**
estimated saving to the £18.37 unit cost per member, at seven-year contract end

**£4.9bn**
MyCSP paid to civil service pension scheme members, 2011-12

**1.5m**
former and current civil servants whose pensions MyCSP administers

**£44.6 million** forecast total net present value of new business for MyCSP over the seven contract years

**£4.9 million** estimated dividend income on the government's 35 per cent shareholding in MyCSP over seven years

**£15.5 million** market value of cash and services Equiniti Paymaster, the private sector partner, offered for its 40 per cent stake in MyCSP

**32 per cent** potential reduction in headcount for administering the civil service pension scheme

**12 months** to establish the mutual joint venture, after publicly announcing plans to transform MyCSP

# Summary


**1** MyCSP is the organisation that administers civil service pensions for 1.5 million public sector employees (scheme members). It collects data on civil servants' work history and pays them a pension on retirement. The civil service pension scheme (the Scheme) relates to salary, with payments being made out of member contributions and general taxation. In April 2011, the Cabinet Office (the Department) announced plans to change MyCSP from a government activity into the government's first mutual joint venture, a process known as spinning-out.

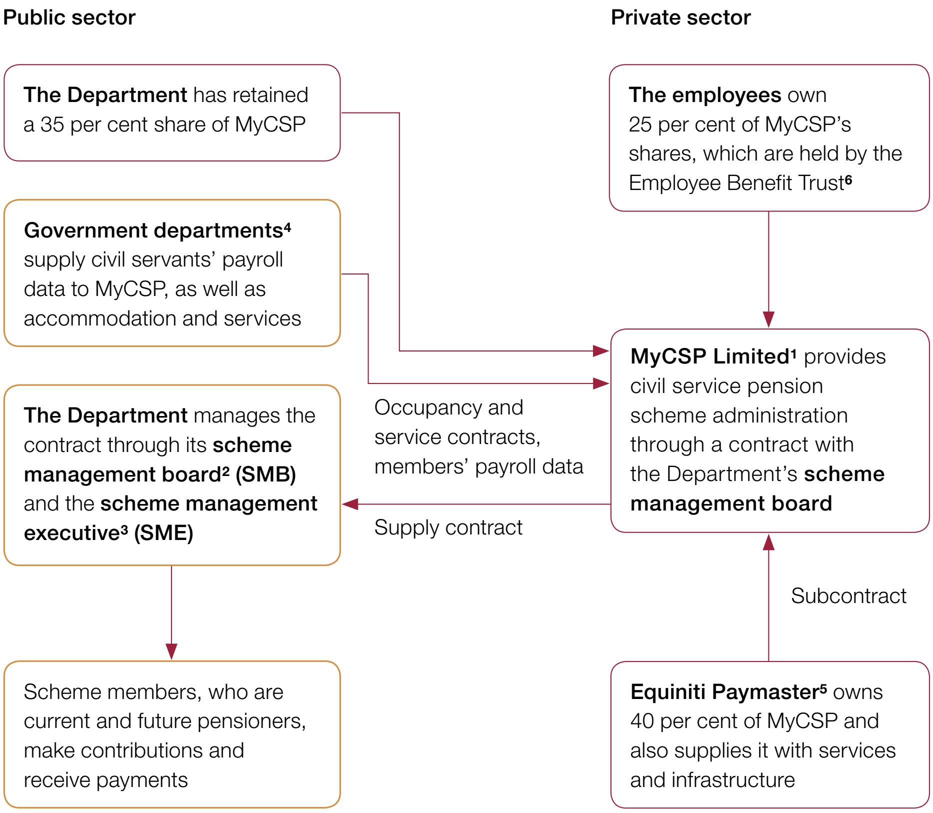
**2** To create the mutual joint venture the Department sold 40 per cent of MyCSP to Equiniti's Paymaster business (Paymaster), a private sector pensions' administration provider, and transferred for nil consideration 25 per cent of the newly formed company to its employees, with the shares being held in trust. The Department retained the remaining 35 per cent. At the same time as creating the new company the Department agreed a seven-year contract (with an option for the Cabinet Office to extend the contract for a further three years) with MyCSP Ltd for MyCSP to sell pension administration services back to the Department.

**3** The transaction was complex, and the Department had to fulfil several different roles, for example being vendor and owner of MyCSP's shares, as well as purchaser of MyCSP's services for scheme members. **Figure 1** overleaf shows the structure of the transaction with details of the key parties. **Figure 2** on page 7 explains the corporate structure of the mutual joint venture.

**4** At the time of the Department's decision to spin-out, MyCSP's service was expensive, its service quality was at the bottom of what the scheme management board (SMB) considered acceptable and it needed major investment. It was also in the middle of a longer-term improvement programme but still cost £18.37 per member per year, twice as much as the best-in-class public sector comparator.

**5** The Department decided to spin-out MyCSP because it wanted the investment in infrastructure and expertise that a private sector partner could bring, to help transform the business. Public and private sector pension schemes require similar administration services. The Department decided to structure the transaction in two phases to give the private sector party time to bring its investment and expertise to bear on the transformation. The first phase would cover creating the mutual joint venture and a contract for ongoing administration services. But the price of transforming the IT infrastructure and operating model would be left open within a specified range. The second phase would fix a price for this transformation.

## Figure 1
MyCSP has a number of different stakeholders




**Notes**

1 MyCSP Limited has a seven-year supply contract with the SMB (the customer for Scheme members and employers), with a three-year extension option, to administer the Principal Civil Service Pension Scheme. Figure 2 provides more information on MyCSP's corporate structure.

2 The SMB manages civil service pension arrangements for the Cabinet Office accounting officer and represents Scheme member interests. The SMB comprises 12 members. There are ten voting members including: the chairperson; one HM Treasury or Cabinet Office representative; four employers; and four Scheme members; and two non-voting non-executive members.

3 The SME support the SMB, undertaking day-to-day management and governance of the Scheme.

4 Government departments, as employers, have agreements with the SMB setting out their roles and obligations in supporting delivery. They provide Scheme member data to MyCSP on civil servants' work history. The Department for Work & Pensions (DWP), the Home Office, the Ministry of Defence and HM Revenue & Customs supply accommodation and facility services to MyCSP under contract.

5 Equiniti Paymaster owns a 40 per cent stake in MyCSP and has a subcontract to supply services and expertise to MyCSP.

6 The Employee Benefit Trust manages the 25 per cent trust holding owned by MyCSP employees.

Source: National Audit Office

**Figure 2**

MyCSP is a joint venture

**MyCSP Ltd board**

Chair

CEO MyCSP Ltd

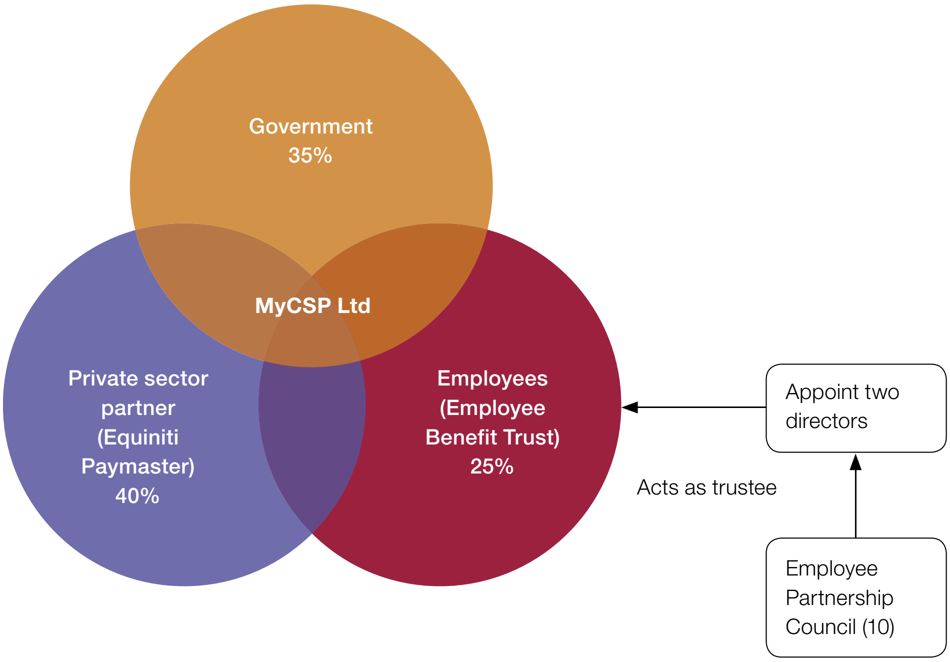
CFO MyCSP Ltd

Government non-executive director (NED)

Paymaster NED

MyCSP Ltd employees NED

(Support: mutual guardian/ company secretary)




**Note**

1 MyCSP Trustee Company Ltd holds the shares for the employees.

Source: National Audit Office

**6** The Department identified this transaction as ripe for testing government's policy of promoting consideration of a wider range of alternative commercial delivery models. There was very little empirical evidence from the British public sector on which to base the value-for-money case. The government took forward the mutualisation on the basis of it being a 'pathfinder' that would gain vital evidence and learning on public sector productivity improvements.

**7** Subsequent to the Department's decision to spin-out MyCSP, we qualified the civil service superannuation accounts for 2011-12 due to an error rate of 6 per cent by value of all payments made. MyCSP relies on data from government departments and organisations to make accurate payments. The qualification was an illustration of the data problems that MyCSP faces.

**8** MyCSP has annual fee income of around £35 million, of which around £30 million comes from government departments, for administering civil service pensions. It currently employs around 400 people at five sites across England. Total payments were projected to be £191 million at current prices over the seven years. In 2015, the government is introducing a new scheme based on career average earnings, which will require much more complex data to administrate. The transaction cost £7.7 million, of which £4.9 million was on external lawyers and consultants. The Department estimates that the proportion of cost relating to the creation of the company as a mutual joint venture was £2.1 million.

## Scope of the report

**9** This report evaluates the spinning-out of MyCSP, and the evidence to date on its efficiency and effectiveness. We recognise that the deal was signed-off with 'pathfinder' status, and have evaluated its effectiveness in fulfilling that role also. We have benchmarked the spin-out against good practice from other business and asset transfers. We also evaluated MyCSP performance since it has spun-out against expectations, including protections for the taxpayer and the potential impact on quality for scheme members.

**10** The report assesses whether the Department has secured overall value for money to date from spinning-out MyCSP, and the remaining risks to value for money, including:

- the current level of value for money offered by MyCSP and how well the Department appraised the alternative options for transforming it (Part One);
- how well the Department prepared for and executed the transaction (Part Two); and
- how well MyCSP has performed so far, whether the benefits are being realised and the risks to longer-term success (Part Three).

## Key findings

### Rationale for the deal and potential benefits

**11 There is significant potential value in this deal for the government and scheme members.** The cost to the government is projected to drop by 25 per cent to £13.78 per member per year by year seven of the contract. Furthermore, the Department has an option to extend the contract by three years to secure a cost of £10.08 per member per year at current prices, which is similar to the current best-in-class public sector comparator. Scheme members should receive a better quality of service underpinned by a payment mechanism that penalises MyCSP if it misses the service standard levels set out in the contract. The government may also receive income from dividends and any future sale of shares (paragraph 1.12, Figure 6).

**12 Value for money for the deal rests on the status of the chosen delivery model as a 'pathfinder'.** MyCSP needed investment to avoid further deterioration of its service and to replace outdated IT infrastructure, so the status quo was not an option. The Department decided to use MyCSP as a pathfinder to test government's policy of promoting consideration of a wider range of alternative commercial delivery models. However, the value-for-money case was uncertain because the Department was not explicit about pursuing the project as a pathfinder, the costs compared with alternative options, or the relationship of MyCSP's costs as a government activity to those of a stand-alone commercial entity. However, the Department wished to avoid bidders incurring unnecessary bidding costs in exploring alternative models which it considered unlikely to progress. There was also very little evidence in the British public sector on the impact of employee ownership. Furthermore, the Department tested the outsourcing option only informally with market providers, and did not test alternative ownership structures at all (paragraphs 1.3–1.11, 2.22).

**13 The Department did not set up the transaction initially to maximise applicable learning.** Pathfinders are innovative projects that government uses to generate knowledge and learning on good practice, so that problems can be avoided in future projects. They need to fully analyse costs, risks and alternative options, and include from the outset ways to capture and disseminate learning (paragraph 1.11).

**14** The government's programme team and MyCSP suffered from a lack of continuity of key people throughout the transaction, which initially limited the scope for knowledge transfer and capturing lessons learnt. The Department is tracking MyCSP's progress through its representation on MyCSP's board, and now has an evaluation strategy to measure the longer-term impacts and changes in productivity (paragraphs 3.18, 3.19).

## Planning and executing the transaction

**15 The Department's early planning of the deal suffered from poor governance with no separation of duties between programme manager and contract supplier.** In planning the transaction the government had five distinct roles, each with different and sometimes competing interests, but it had a relatively small team. The Department did not initially understand these various roles and there was therefore a conflict of interest and an imbalance of power between different parties. In particular, the chief executive officer of MyCSP, while negotiating the supply contract with the scheme management executive, was also head of the overall transformation programme. This meant he had control over allocating programme resources and access to senior management and information. This was not the case for other parties, in particular the scheme management executive. Furthermore, in common with all MyCSP employees, he had a potential personal financial interest depending on the choice of option (paragraphs 2.2–2.6).

16 **The Department's transaction timetable target and financial model did not reflect commercial reality.** The initial programme team and director did not have extensive experience or understanding of what was required in spinning-out an organisation. They set an ambitious target of executing the deal within three months, which had to be slipped repeatedly, finally taking 12 months. The financial model was prepared by a consultant on secondment to MyCSP. However, MyCSP gave the model limited exposure to the bidders or other operators in the market to test its commercial reality. The bidders we spoke to have highlighted its lack of realism. For example, there was unrealistic timing of cost reductions and optimism in revenue forecasts. MyCSP has since identified errors in the financial model totalling £1.7 million (paragraphs 1.8, 2.7–2.10, 2.18, Figure 14).

17 **The Department managed the transaction much better after it responded to the intervention of the Cabinet Office audit committee.** Four months into the planning, and in response to audit committee concerns, the Department put in place four key stakeholder tests that the transaction had to pass before it could proceed. Each test had a senior responsible officer and clear approvals processes and accountabilities. The tests covered the interests of government, MyCSP, the taxpayer, and current and future pensioners (paragraphs 2.11–2.13).

18 **The Department ran a good competitive procurement and despite a loss of competitive tension in the final stages it achieved an outcome consistent with the market.** There were 14 high-quality opening bidders, including existing pensions administrators and new entrants to the market, of which the Department shortlisted four. Bidders felt the government transaction team was high quality, but data for due diligence could have been of better quality. Also, they did not see the financial model or have any input into the supply contract, for example to incorporate innovations, until very late in the process. The signed deal gives MyCSP a 14 per cent projected mark-up of costs, which is consistent with a competitive market rate (paragraphs 2.16–2.19).

19 **The Department chose not to fix the price for years three to seven of the contract until after the contract was signed because of the uncertainty of the cost of transformation.** At contract signature the Department agreed a price range that allowed a 10 per cent drop or 5 per cent rise, to be fixed after six months of operation. This was intended to give the new company and its private sector partner time to understand the organisation's costs and the best way to transform the service. The deal contained a number of protections, such as gainsharing, and the government retained a substantial minority stake, which is good practice. A fixed price was finally agreed in March 2013, ten months after the deal was signed. The price is within the 5 per cent cap, but has £5.7 million of additional costs including items not identified in the original business case. The deal delays transformation for a year, but the total cost is within the estimate of optimism bias included within the business case (paragraphs 3.2–3.5, 3.11, 3.12, Figures 12 and 14).

## Early progress of MyCSP and risks to achieving deal objectives

**20 MyCSP responded quickly to the early shock of markedly lower revenue than anticipated, but first-year profits were just over half of those expected.** MyCSP's business plan, which was reflected in the Department's business case, projected that £5 million (14 per cent) of MyCSP's first-year revenue would be from administering civil service redundancy compensation payments. This income stream depended on the actual number of redundancies with MyCSP taking the risk on volume. Redundancy income has been 92 per cent below expectation with MyCSP not projecting any improvement. In response, MyCSP has brought forward its redundancy programme, and brought some outsourced work back in-house, alongside a number of smaller efficiency savings. In its first year, MyCSP made a profit of £1.7 million, against an initial expectation of £3.1 million (paragraphs 3.7 and 3.8).

**21 The Department was over-optimistic in trying to set up a comprehensive performance payment mechanism from the start of the contract.** The payment mechanism increased in phases the number of performance indicators from eight to 162. The management information systems were not in place to measure performance, and the IT infrastructure to make the quality improvements was not envisaged to be in place until year three of the contract. The system is currently suspended while MyCSP remedies data problems inherited from the legacy organisation and completes the transformation plan. The Department has agreed an improvement plan with MyCSP for performance data (paragraph 3.14).

**22 MyCSP employees report rising levels of engagement.** Fifty-two per cent of employees would recommend MyCSP as a great place to work, more than double the amount prior to the company trading. Furthermore, 60 per cent of staff believe that senior leaders have a clear vision for the future, and 59 per cent value being an employee owner rather than just an employee (paragraph 3.10 and Figure 13).

**23 The Department has protections from service failure, but Paymaster has limited exposure in the event of catastrophic failure.** The contract has appropriate mechanisms, such as step-in rights, should MyCSP fail to provide an adequate service. The Department also seeks to influence MyCSP through the Department's own non-executive director. This individual potentially has a conflict between the company and taxpayer interests so the Department has established governance arrangements to help mitigate these. MyCSP's current financial model shows that it would need a 12 per cent drop in expected revenue or a 15 per cent rise in budgeted costs for it to start making losses. As MyCSP started with only £3 million of cash and relies on a single contract, it carries high risks relative to its market competitors. In the event of catastrophic failure of MyCSP, Paymaster's liability is limited to its equity, valued at £15.5 million at financial close, the value of the services it provides to MyCSP, and any associated liabilities contained within the key subcontracts covering the provision of these services. It would, however, also suffer reputational damage in its core area of business (paragraph 3.2–3.5, Figure 2 and Figure 12).

24 **The deal means that MyCSP now has a credible proposition for meeting the challenges of the 2015 pension reforms.** Paymaster is injecting £12.5 million of IT infrastructure and support and £3 million of cash to help enable MyCSP to meet the much more complex requirements of the 2015 career average scheme. MyCSP currently reports being on track to achieve the transformation needed for 2015. A significant proportion of the payroll data that government departments give to MyCSP is, however, poor quality. The Department and MyCSP are developing improvements to meet the requirements of the new scheme (paragraphs 2.21, 3.15 and 3.20).

## Conclusion on value for money

25 At this stage the spinning-out of MyCSP has potential to achieve good value for money with a projected 25 per cent reduction in costs for the government and service improvements for members. However, the poor quality of existing data and infrastructure and the different understanding between the parties of some aspects of the deal mean that although the Department signed the deal in May 2012, it took another ten months to agree a final price to transform the service. Furthermore, the Department and MyCSP still face a number of large challenges, as shown by the Department currently suspending payment deductions for poor performance. Given these challenges, and the forthcoming 2015 pension changes, the government will need to remain actively engaged as customer, shareholder, and supplier. This will ensure that risks do not revert back to government and will capture fully the potential benefits of the deal.

26 The Department did not initially optimise the opportunities to learn from this transaction as a pathfinder, but has now reviewed the lessons learned from executing the transaction and has put in place an evaluation strategy. It did not evaluate fully the opportunity cost of the pathfinder and consequently lacks robust data against which to compare its performance, for example on the value given up for employee engagement. Staff turnover in the project team and in MyCSP has been high throughout the transaction, limiting scope for learning. For the transaction to achieve value for money the Department must press on with evaluating the longer-term comparative performance of MyCSP, and capture and disseminate the lessons learned from running the transaction.

## Recommendations

### Recommendations relevant to this transaction

a **The Department and other government departments need to resolve problems with the quality of data they supply to MyCSP.** Remedies will need to be in place in time for the new 2015 pension scheme.

b **The Department needs to ensure that the performance payment mechanism is fit for purpose as soon as possible.** The contract is currently weakened by the suspended payment mechanism. The Department is currently reviewing it with MyCSP and should ensure that management information is of sufficient quality to restart the mechanism.

c **To learn the lessons fully the Department needs to implement its evaluative framework to measure MyCSP's progress over the longer term.** The Department should ensure that it evaluates over the course of the deal productivity gains arising from the impact of mutualisation. It should use a variety of quantitative and qualitative methods.

## Recommendations for future transactions

d **In future, business cases should fully appraise all the viable alternatives.** The business case did not include a proper assessment of the alternative delivery models. This would have helped the Department to understand the value of the different options, and would have allowed it to monitor the value for money of its chosen option against the alternatives.

e **Government should use the learning on governance arrangements for non-executive directors to inform future similar cases.** Government non-executive directors have a potential conflict of interest between their duties to the company and the taxpayer. The governance arrangements in this transaction have so far mitigated any risks.

f **In future transactions, the government should fully integrate commercial and operational experience to the team early on, so planning reflects commercial reality.** This is necessary so that the timetable, risk management, financial model, and project and task planning reflects realistically the commercial complexity of the transaction.

g **The government should use the insights and learning from this transaction in instances where it wants employee engagement to be a feature of future delivery.** MyCSP was spun-out with 25 per cent employee ownership, but the government should not presume that this is a benchmark figure. The Department had very little evidence from the British public sector for MyCSP's business case on the impact of employee ownership on productivity.

h **The Department should press ahead with standardising the legal documents and process for spinning-out public services to reduce the cost of execution.** The programme costs for this pathfinder transaction were £7.7 million, which is more than 20 per cent of MyCSP's annual income.

i **Where the government is planning future spin-outs it must properly separate the various different roles and decision-making.** This will ensure clarity of decision-making and proper accountability.

# Part One

## Reason for mutualising MyCSP

**1.1** This part explains MyCSP's role and operation. It examines the background to the mutualisation and the rationale and value-for-money case for the transaction. It explains the following findings:

- MyCSP needed to be transformed because its IT was not fit for purpose, its costs were high, and it had a high error rate in making payments. The mutualisation envisages it matching the current performance of the best-in-class providers by the end of the deal.
- The government decided to spin-out the organisation into a mutual joint venture to get private sector investment and expertise, and improve employee engagement. However, it was not explicit about the cost of alternative options and the business case contained a relatively high degree of assumed data.
- Given the lack of evidence on the impact of mutualisation, the government gave the transaction 'pathfinder' status.

### Role and description of MyCSP

**1.2** MyCSP administers the Principal Civil Service Pension Scheme[1] (the Scheme) for more than 1.5 million past and present civil servants (scheme members) and more than 250 employers. MyCSP also provides pension payroll, injury benefit and civil service compensation scheme services. The civil service pension covers five different schemes (**Figure 3**) which relate to salary and are paid out of member contributions and general taxation. During 2011-12, the scheme received £3.1 billion of contributions and other income and paid out £4.9 billion of pension benefits. MyCSP has annual income of around £35 million, of which around £30 million is for administering civil service pensions.

1 The Principal Civil Service Pension Scheme is an unfunded, defined benefit, contributory, public service occupational pension scheme that covers four pension scheme arrangements. There is no fund of assets from which benefit payments are made, instead employers and employees' contributions are paid to sponsoring government departments as though the scheme were funded.

**Figure 3**
MyCSP administers a range of schemes

| | Nuvos | Classic | Classic Plus | Premium | Partnership |
|---|---|---|---|---|---|
| Scheme type | Defined benefit scheme | Defined benefit final salary scheme | Defined benefit final salary scheme | Defined benefit final salary scheme | Defined contribution or stakeholder scheme |
| Open/closed to new members | Open | Closed | Closed | Closed | Open |
| Member contribution | Yes | Yes | Yes | Yes | Optional |
| Normal pension age | 65 | 60 | 60 | 60 | At discretion of policyholder |

**Active members** – 523,000

Current civil servants enrolled in a scheme and paying contributions

**Recipients** – 622,000

Former civil servants now retired and receiving a pension as a beneficiary

**Deferred** – 365,000

Former civil servants with deferred benefits who are not yet retired

Source: MyCSP business plan and Cabinet Office: Civil Superannuation Accounts 2011-12

## The need to transform the business

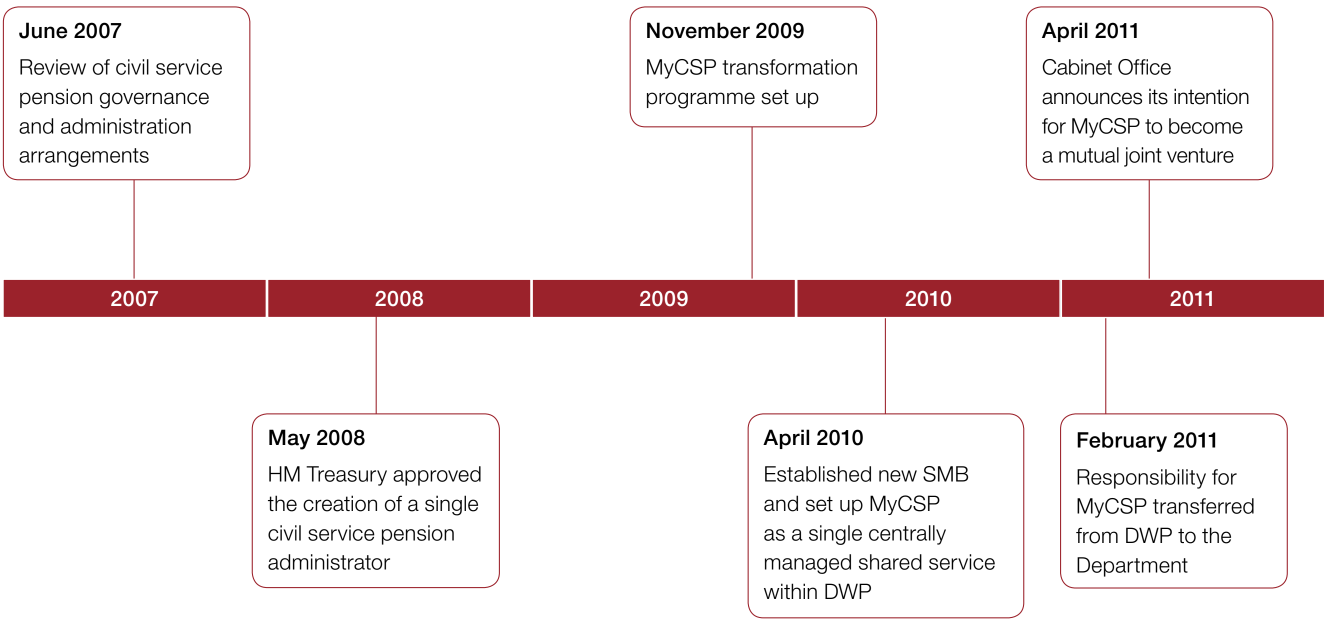
**1.3** MyCSP has high costs, which fall on the taxpayer. Our analysis of comparator public pension administrators found that MyCSP is nearly double the cost per member of the equivalent teachers and NHS schemes. MyCSP also had very old IT infrastructure, which was no longer fit for purpose and contributed to poor quality of service and breaches in data protection. Our audit of the superannuation account for 2011-12 found an error rate of 6 per cent of the value of all payments made due to incorrect information held by participating employers. Furthermore, the 2010-11 and the 2011-12 accounts were qualified for lack of evidence to support some of the payments made. This meant that some pensioners were receiving more or less than they were entitled to. The scheme management board (SMB), which represents members, considered that MyCSP's service levels were at the very bottom of what they would consider acceptable.

**1.4** When the government decided to spin it out, MyCSP was already in the middle of a transformation programme (**Figure 4**) for which it had approval to invest £63 million on transformation and IT. The delivery model had been complex and fragmented. There were nine pension administration centres in different government departments, various private and public payroll providers, and a central Cabinet Office (the Department) unit responsible for governance and delivery. The Department for Work & Pensions (DWP) had overall responsibility for the operation. On 1 February 2011, sole responsibility for MyCSP transferred to the Department. However, staff were still employed by the DWP.

## The decision to spin-out

**1.5** In April 2011, the Minister for the Cabinet Office announced plans to transform MyCSP into the first government mutual joint venture. This was against a background, since May 2010, of the coalition government promoting consideration of mutuals and cooperatives, alongside other commercial delivery models, across the public sector as a key policy for its public service reform programme. The Department considered that it needed a quick and innovative approach as well as a cash injection to fund the business transformation. This was because of the lack of available public sector funding, combined with the need to make savings and avoid further deterioration in customer service. Without this approach, the Department estimated it would have needed to spend £63 million on transformation and IT. The intention was for MyCSP to be a 'pathfinder' transaction, although this was not made very explicit at the time.

**Figure 4**
MyCSP has already undergone a long period of transformation




Source: National Audit Office analysis of Cabinet Office documentation

## Justification for the mutual joint venture

**1.6** The Department's April 2011 announcement predated the outline business case in June 2011. This meant that it had decided on the business model before doing an options appraisal. The Department, however, chose to evaluate three delivery models: in-house transformation; outsourcing; and mutual joint venture. The Department compared the three delivery options against a baseline of a minimum level of investment to maintain the status quo.

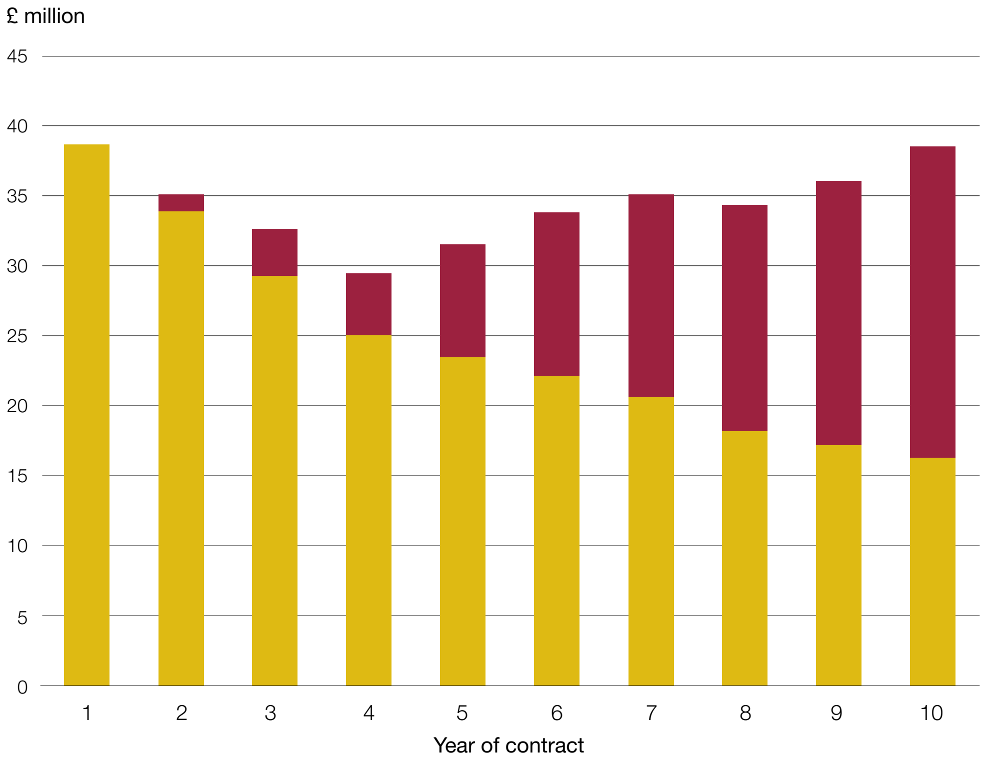
**1.7** The business case calculated a total benefit of £19.5 million for the mutual joint venture over the do-minimum option and an £18 million benefit over outsourcing, the next best alternative. However, this difference, and the ranking of the alternatives was very sensitive to assumed future business growth. The business case assumes that MyCSP will grow its business so that 41 per cent of its income (£15 million) by year seven will come from new business (**Figure 5** overleaf). We evaluated MyCSP's core market and found that MyCSP needs to capture around 17 per cent of its core business market to meet its business case assumptions. The private sector bidders questioned the projections for MyCSP winning new business, given that the pension administration market is highly competitive and mature.

**1.8** The Department only informally contacted market suppliers about the outsourcing option. It did not seek views on key aspects of its chosen delivery model, in particular the impact on price of different levels of private sector and employee shareholdings, or business growth assumptions. The financial model supporting the business case was built by a consultant on secondment to MyCSP. The consultant used cost data from MyCSP's previous year of operation and projected forward from this using a number of theoretical assumptions.

**1.9** The assumptions in the model were not exposed to market suppliers except at a very late stage with the bidders. The bidders we spoke to commented on its lack of realism in the timing of cost allocations and the optimism of growth assumptions. MyCSP has since identified errors in the model totalling £1.7 million. Much of the cost data was derived from internal cost allocations reflecting MyCSP's costs as a government activity rather than a stand-alone commercial entity subject to market prices. There was a lack of challenge to the model and underlying assumptions for commercial reality. Combined with no market data, the assessed monetary benefit of the value-for-money case is uncertain, as is the data on the costs and benefits of pursuing the pathfinder option compared with other options such as giving the private sector party full operational control.

**1.10** In evaluating the business case, HM Treasury recognised that the options appraisal had been limited and that the value-for-money case was weak. It recognised, however, that the purpose of the mutual joint venture was a 'pathfinder'. The venture would provide learning on how to structure such deals and their impact, and on the impact of employee engagement, and HM Treasury approved it on this basis. HM Treasury did, however, request that the Department evaluate the transaction after 12 to 18 months and report back its findings.

## Figure 5
MyCSP is anticipating winning new business




| | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
|---|---|---|---|---|---|---|---|---|---|---|
| New business revenue (£m) | 0 | 1 | 3 | 4 | 8 | 12 | 15 | 16 | 19 | 22 |
| SMB contract revenue (£m) | 39 | 34 | 29 | 25 | 23 | 22 | 21 | 18 | 17 | 16 |
| **Total revenue (£m)** | **39** | **35** | **32** | **29** | **31** | **34** | **36** | **34** | **36** | **38** |

Source: MyCSP business case

**1.11** We examined a number of pathfinder projects and programmes right across the public sector, for example in housing,[2] healthcare,[3] and the private finance initiative.[4] The purpose of a pathfinder is to test and establish good practice for a new initiative and ensure that lessons are learnt before full roll-out or implementation. A pathfinder therefore needs to be established after detailed analysis of the costs, risks, and alternative models of delivery. The novelty of a pathfinder project is likely to result in an additional cost. To achieve value from this additional cost the pathfinder must be set up from the outset with ways to capture learning on how the chosen delivery model works, to measure its success, and to disseminate the knowledge gained.

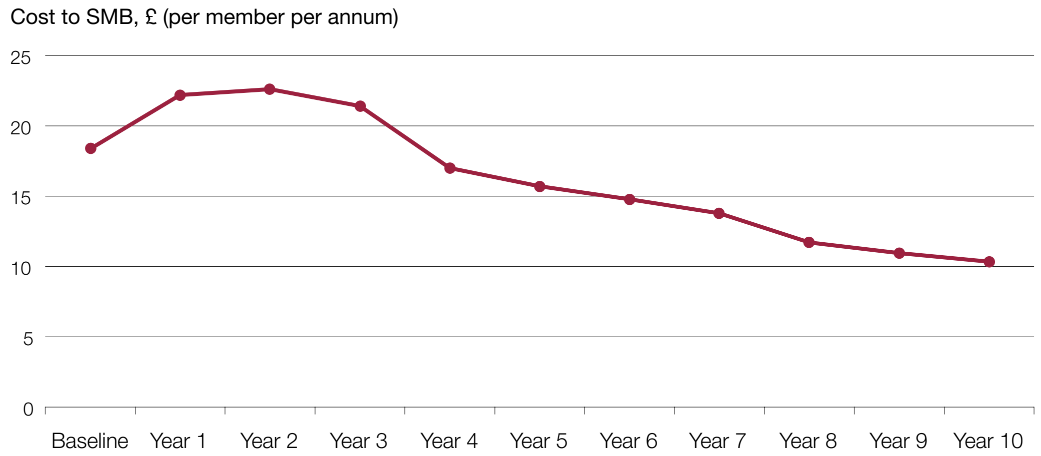
2 Comptroller and Auditor General, *Department for Communities and Local Government, Housing Market Renewal*, Session 2007-08, HC 20, National Audit Office, November 2007.
3 Comptroller and Auditor General, *Department of Health, Innovation in the NHS: Local Improvement Finance Trusts*, Session 2005-06, HC 28, National Audit Office, May 2005.
4 Comptroller and Auditor General, *The Refinancing of the Norfolk and Norwich PFI Hospital: how the deal can be viewed in the light of the refinancing*, Session 2005-06, HC 78, National Audit Office, June 2005.

## Intended benefits

**1.12** The Department expects spinning-out MyCSP to achieve significant benefits. The cost of the service to government departments is projected to fall by 25 per cent to £13.78 per member by the end of the seven-year contract. Futhermore, the Department has secured the option of a three-year extension with the price dropping to £10.08, (**Figure 6**). The Department may also make dividend and sale income. Scheme members and employers should benefit from better customer service through: modernised IT systems; better data quality; a greater choice of communication channels; more efficient streamlined processes; and the ability to withhold payment if services fall below specified quality thresholds. The Department expects employees to receive an annual dividend equivalent to about 2.5 per cent of their salary, along with having the opportunity to be involved in managing the business. The Department expects that the 25 per cent employee shareholding will lead to a productivity gain of 1 per cent per year through greater involvement and motivation.

**Figure 6**

Spinning-out MyCSP as a mutual joint venture is planned to halve the Department's costs




| | Baseline | Year 1 | Year 2 | Year 3 | Year 4 | Year 5 | Year 6 | Year 7 | Year 8 | Year 9 | Year 10 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| ● Per member per annum (£) | 18.37 | 22.20 | 22.62 | 21.43 | 17.00 | 15.72 | 14.78 | 13.78 | 11.71 | 10.96 | 10.34 |

**Note**

1 The cost per member per annum drops to £10.08 in the final month of the contract.

Source: MyCSP full business case

# Part Two

## Preparing and managing the transaction

**2.1** This part examines the preparations for spinning-out including the transaction, planning and governance. It finds that:

- The initial planning by the Cabinet Office (the Department) of the transaction was not sufficiently grounded in previous related experience, resulting in an ambitious target for the timetable and poor risk management and governance arrangements. Planning did, however, improve after the Department responded to issues raised by the Department's audit and risk committee.
- The competitive procurement was tightly managed by an effective team in the Department. It attracted a good level of interest from high-quality bidders, although there was a loss of competitive tension towards the end. Furthermore, the Department left it late to involve the private sector parties in the transaction.

### Planning for the transaction

**2.2** The Department did not consider the impact on the programme infrastructure of changing from a partially complete in-house transformation to spinning-out MyCSP as a mutual joint venture. For example, spinning-out fundamentally changed the nature and complexity of the roles, responsibilities and skills required to complete the transaction. There was no in-depth assessment of the implications of this change on the required governance arrangements and skills, or the impact on the overall programme timetable.

### Governance arrangements for planning

**2.3** In spinning-out MyCSP the Department had five different roles: as vendor, supplier to MyCSP, owner of MyCSP, MyCSP the business, and as the customer of MyCSP (**Figure 7**). These different roles and responsibilities sometimes conflicted. For example, the Department as customer, through the scheme management board (SMB), sought the best deal for scheme members and employers. However, the Department as part-owner of MyCSP wanted the business to increase profit and grow in value. The Department for Work & Pensions (DWP), the Home Office, the Ministry of Defence and HM Revenue & Customs also provided, under contract, MyCSP with nearly £3 million (10 per cent of MyCSP's costs) of accommodation and facilities.

## Figure 7

The Department has numerous roles and responsibilities

| Department's roles | Responsibilities | Advisers and their roles |
|---|---|---|
| **Vendor** of MyCSP | Achieving the best deal for the private sector share on offer | **TSol ERG legal, and Herbert Smith.** Advising on business transfer agreement |
| **Supplier** to MyCSP | Agreeing occupancy and service contracts with the host government departments | **TSol ERG legal, and Herbert Smith.** Advising on occupancy and service contract terms |
| **Part-owner** of MyCSP (35 per cent) | Negotiating a deal that allows MyCSP to grow in value | **TSol ERG legal, and Herbert Smith.** Advising on constitutional documents |
| **MyCSP** business unit | Negotiating the best possible contract to spin-out with | **Herbert Smith.** Advising on contract terms<br>**PwC.** Consultant seconded as interim chief finance officer |
| **Customer** of MyCSP – SMB | Negotiating the best deal for the Scheme members and employers | **TSol Commercial & Field Fisher Waterhouse.** Advising on contract terms |

Source: National Audit Office analysis of Cabinet Office documentation

**2.4** The initial transaction planning team, and director of the programme team, had limited experience of this type of transaction. They consequently did not sufficiently appreciate or define the Department's different roles and how they interacted. The inadequate separation of duties and poorly defined Department roles caused confusion and uncertainty for external parties. The SMB's legal advisers were sometimes unclear, during negotiations, whether the MyCSP programme director was acting for the SMB as customer or MyCSP the business. This led to challenges during negotiations as people were not always clear what the priority was and which role a person was carrying out at any one time. The Department did not understand its roles, which meant that these conflicts were poorly managed in the early phase of the transaction and led to challenges in keeping responsibilities aligned. A review by Internal Audit found that the lack of clarity over roles and responsibilities led to "too fluid an environment for effective leadership".

**2.5** There was a significant conflict of interest at a senior programme level. The senior responsible officer for the programme was also the chief executive officer of MyCSP. He therefore had control over allocating resources, access to senior management and officials, and information, while also negotiating the contract for MyCSP with the SMB. In common with all MyCSP employees he also had a potential personal financial interest, as a future employee shareholder of MyCSP, depending on the chosen option.

**2.6** In June 2011, the Major Project Authority (MPA) assessed the programme and found that no individual party could be identified who 'owned' the business case. An internal audit review found that "there was no clearly articulated and well understood strategy for delivering both the SMB and private sector partner contracts and MyCSP constitutional documents and how these aligned and would interact". The main contractual and constitutional arrangements are set out in Figures 1 and 2.

## Timetable viability

**2.7** The Minister for the Cabinet Office set a target of July 2011 to launch MyCSP and find a private sector partner through a competitive procurement, which was three months after announcing the venture (**Figure 8**). The target prevented splitting out the supply contract from spinning-out MyCSP. Doing these concurrently increased the complexity of the deal and put greater pressure on the programme team as the Department provided no additional resources. The transaction now involved the Department simultaneously negotiating the supply contract between the SMB and MyCSP and the subcontract between MyCSP and the private sector partner. This meant there was less opportunity for the bidders to input to the supply contract than could have been the case, for example to raise areas where they saw potential for service innovation.

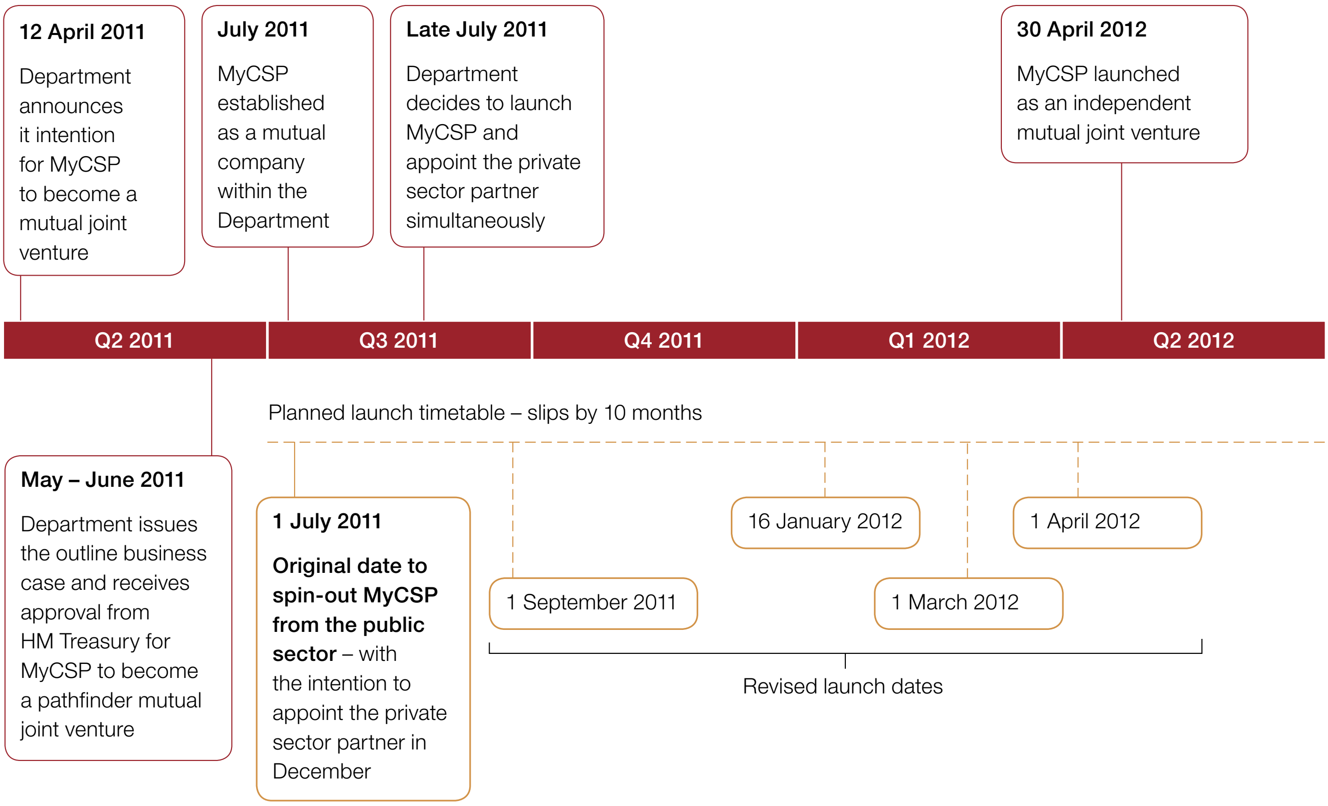
**2.8** The timetable proved ambitious and the launch date slipped several times. The deal eventually took more than 12 months to complete, some ten months longer than originally planned, although not an unreasonable length of time given the complexity of the transaction. Had the Department planned for this timescale originally, it would have been able to give more time to talk to the bidders and test key assumptions with the market.

## Reliance on advisers

**2.9** The programme team was thinly resourced, and the Department had not fully assessed the resources or skills necessary to do the deal. As a consequence, the programme relied heavily on advisers to do sometimes quite minor work. Furthermore, the programme was led from within MyCSP, whose management team had little or no business experience outside the public sector. The programme team relied heavily on its financial consultant, who had also been seconded in as MyCSP's interim chief finance officer. Many of the parties we interviewed acknowledged that this person was crucial to driving the deal through. The same consultancy firm was also advising the SMB. The separation of work streams guarded against potential conflicts of interest.

## Figure 8

The original target for the project timetable was unrealistic




Source: National Audit Office analysis of departmental documents

**2.10** Although there were two teams of legal advisers to represent different sets of interests within government the confused governance arrangements for the deal meant that there was also some lack of clarity over legal representation for the Department's different roles (Figure 7). The Department as vendor, supplier and owner and the MyCSP team shared Herbert Smith as legal advisers. The SMB initially relied on a separate team of HM Treasury solicitors but subsequently appointed Field Fisher Waterhouse to provide additional support. The employee benefit trust had no legal representation at all. The SMB's lawyers found that the sharing arrangement between the Department and MyCSP meant that they were sometimes dealing with the same lawyer representing the Department and MyCSP on different occasions.

## Implementation of stakeholder tests

**2.11** The Department's planning and governance of the transaction improved after it responded to concerns raised by the Department's audit and risk committee (the Committee). The Committee was concerned about the governance arrangements and that the Department did not understand its different roles. It requested that the Department introduce a formal approvals process for the deal.

**2.12** In August 2011, the Department established a scrutiny committee to scrutinise the deal for the four key stakeholder groups. The Committee was responsible for signing-off the deal for the Department before submitting it to HM Treasury for approval. Each of the four stakeholder groups was led by different senior government officials. They were charged with clearly understanding the conditions that would need to be satisfied to sign-off the deal. The four groups were:

- MyCSP business readiness, covering transformation plus providing business as usual;
- the customer, representing current and future pensioner interests;
- the taxpayers' representative, to ensure independently that the taxpayer's interest was protected; and
- the owner of the Department's interest and the integrator, to certify that the programme overall was fit to proceed.

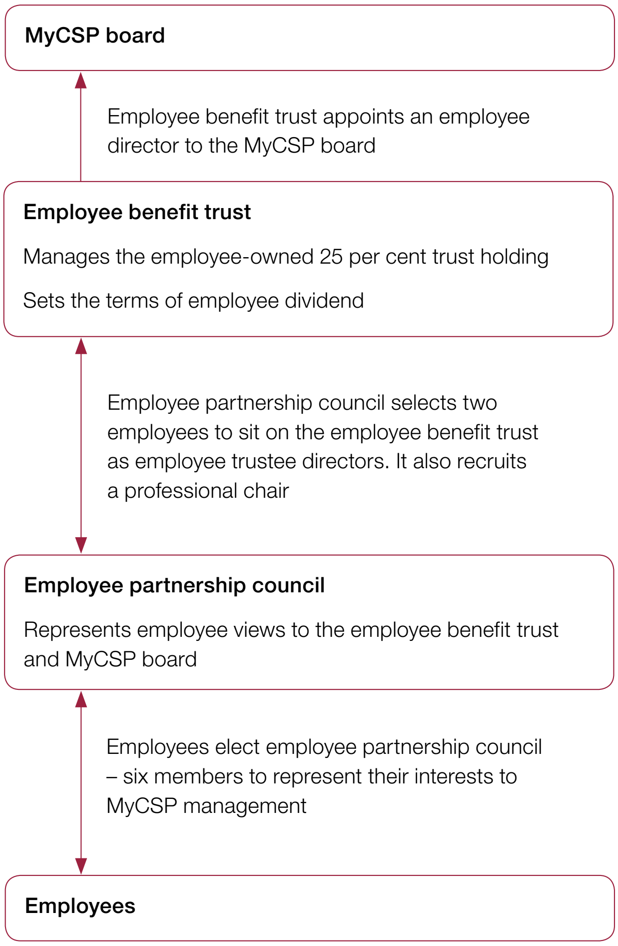
**2.13** The Committee's intervention ensured that there was a proper approvals framework with a clearer decision-making chain. It provided more fully defined responsibilities and accountabilities for each of the key stakeholders. It also gave assurance that agreed conditions had been met and risks associated with spinning-out had been identified and resolved or accepted before final sign-off.

## Employee engagement

**2.14** There was no communication with staff about the decision to transform MyCSP into a mutual joint venture before the Department announced its intention in April 2011. MyCSP's management team subsequently spent much time with staff to address their concerns, through activities such as interactive calls for all employees, a series of roadshows and question and answer sessions.

**2.15** The mutual structure of MyCSP (the means for staff involvement) was established in July 2011. **Figure 9** sets out the arrangements.

## Figure 9
Employees are represented throughout MyCSP




Source: National Audit Office analysis of MyCSP data

## Executing the transaction

### Running the competitive procurement

**2.16** The Department's competition team managed the private sector partner procurement well, although the Department's SMB was not initially well represented. The competition to procure a private sector partner began in late May 2011. The Department held a well-attended supplier day during early June 2011 resulting in 14 responses from high-quality bidders, both existing suppliers and new entrants. From this, the Department shortlisted four qualifying bidders. The SMB raised concerns that it had not been consulted on the content of the pre-qualification questionnaire and was later involved in the shortlisting and bid evaluation process.

**2.17** Despite the early part of the competitive procurement being well managed there was some loss of competitive tension towards the end of the process. The Department was left with a single preferred bidder. One of the four shortlisted bidders decided not to submit a final bid as they wanted operational control. The Department scored two of the final three bidders very closely, with the third some way behind. When the Department awarded preferred bidder status to the highest scored bid from Equiniti's Paymaster business (Paymaster)[5], the other bidder with a highly scored bid pulled out as it did not want to commit further resources.

**2.18** The overall margin on the deal for MyCSP increased from 9.53 per cent to 11.49 per cent during the preferred bidder negotiations. These consisted of two sets of changes. The first were to reflect Paymaster's views of operational reality, for example on the timing of cash flows, which were different from those presented in the business case, and increased the charges by £7.4 million over ten years. The second were a result of negotiations over MyCSP's projected margin, and increased the charges by £6.17 million over ten years. The increased margin is broadly in line with market comparators as is MyCSP's projected mark-up of 14 per cent on costs (**Figure 10**).

**2.19** All the bidders commented favourably on the high quality of the team managing the competitive procurement and its fair and balanced approach in its dealings with them. Despite the team's limited resource, bidders said it was always on hand to provide guidance and support for the bidders and worked hard to make the deal happen.

**Figure 10**
MyCSP's mark-up rates are in line with the market

| | 2006 (%) | 2007 (%) | 2008 (%) | 2009 (%) | 2010 (%) |
|---|---|---|---|---|---|
| Average mark-up | 12 | 11 | 9 | 16 | 16 |

Source: Independent research commissioned by the Department

5 Paymaster is the pension administration arm of the Equiniti Group a global private equity owned specialist business services provider.

## The deal structure

**2.20** The deal reached financial close on 1 May 2012. The Department established MyCSP Limited (MyCSP) as the first mutual joint venture to spin-out of central government as a private company. MyCSP has three minority shareholders: the employees through an employee benefit trust (25 per cent); the Department (35 per cent); and a private sector pension administrator, Paymaster (40 per cent).

**2.21** MyCSP has a seven-year commercial supply contract with the SMB, with the SMB having the option to extend for three years. Paymaster, in exchange for its 40 per cent share in MyCSP, is providing £3 million in cash, resources and expertise worth £12.5 million valued at market rates, to transform the business. This gives an overall valuation of MyCSP of around £39 million (**Figure 11**). Paymaster's services are being supplied under the terms of a subcontract between MyCSP and Paymaster.

**2.22** To form the mutual, the Department provided shares to the employee benefit trust at nil consideration. It had very little evidence from the British public sector to help decide the level of equity to give to employees and the consequential impact on productivity. It therefore set the following criteria when it decided to give 25 per cent of the company to the employees:

- The shareholding had to be sufficiently material to the employees to influence their behaviour.
- The overall shareholding allocation needed to be structured to ensure that the parties must work collaboratively if they are to be successful.
- The shareholding allocation should support the intention that the mutual joint venture be classified as not part of the public sector.

**Figure 11**
MyCSP's market value was £38.6 million at acquisition

| Party | Shareholding (%) | Value (£m) |
|---|---|---|
| Paymaster | 40 | 15.5 |
| The Department | 35 | 13.5 |
| Employees | 25 | 9.6 |
| **Total** | **100** | **38.6** |

**Note**
1 We have valued MyCSP on the basis of the market value of Paymaster's consideration. This is a different basis to the carrying value of MyCSP in the Department's resource accounts, which is based on the value of MyCSP's physical assets.

Source: National Audit Office

**2.23** The 25 per cent share gives each employee around £1,100 a year of potential dividend income, or 2.5 per cent of average salary. This is if MyCSP achieves the profit levels projected in the business case. The shares are held by an employee trust, meaning that employees cannot individually sell up. However, the business case financial model predicts a value at year ten of £6,600 per employee should the trust wish to sell its stake. The Department did not seek any changes in working practices in exchange for the shareholding.

**2.24** The Department identified two sets of costs to bring MyCSP up to an acceptable service level. It has classified these as 'transition' costs and 'transformation' costs in the financial model. The Department is funding transition costs, which cover spinning-out the business-as-usual elements of MyCSP. The transformation costs cover the transformation plan and are mainly related to implementing new IT. The Department and MyCSP are sharing these equally.

**2.25** The service credit regime signed up to is challenging compared with MyCSP's previous performance. The contract for MyCSP to supply services to the SMB contains a mechanism whereby payments are deducted if MyCSP fails to reach specified standards of service. This gives the SMB greater power to enforce service standards than previously. The mechanism covers 127 different areas such as completing death benefit payments within two days of receipt. MyCSP has a standard turnaround time of 48 hours, after which financial penalties become payable. Previously, there were 15 service standards with no penalties and to which MyCSP took an average of 20 days to respond.

# Part Three

## Managing the longer-term benefits

**3.1** This part of the report will cover the risks and issues that need to be managed and the early operational experience of MyCSP. This includes the realising of early benefits, and risks to longer-term success. It finds that:

- MyCSP was operationally ready from day one and has made significant progress with reducing costs. Early results indicate that the majority of staff value being employee-owners. However, revenue has been 14 per cent lower than planned and key individuals within the business and in the Cabinet Office (the Department) have already moved on, leading to a loss of corporate memory.
- MyCSP and the scheme management board (SMB) have agreed a transformation plan that preserves the original cost profile but delays the benefits.
- The Department has some protections from service failures, but there are still a number of issues for it to work through to ensure it benefits from the spin-out.

### Risk transfer

**3.2** The Department decided that the cost and operational data on MyCSP's historic performance was insufficient for a private sector party to either determine the best way to transform the service, or to estimate accurately the cost of doing this. For example, MyCSP considered that its projected headcount reductions could be out by as much as 25 per cent with a consequential impact on the contract price of 15 per cent. The Department therefore allowed a six-month period after contract signature for the private sector party to understand fully the business and to re-price the contract including all the transformation costs. The contract was therefore let with a 5 per cent price cap, and a 10 per cent price collar.

**3.3** MyCSP is a relatively high-risk enterprise, being a new entrant into the market, and with income dominated by a single contract. MyCSP has limited available cash to cover early risks. The private sector partner's £3 million cash injection was forecast to rise to £10 million by the end of the first year of trading through the SMB contract income. The majority of the rise, £5 million, depended on highly variable income from administering redundancy payments for the Civil Service Compensation Scheme. Furthermore, MyCSP, unlike larger, more established providers does not as yet have a broad portfolio of products and services to fall back on, should cash flow become tight.

**3.4** Our analysis of its current financial model shows that MyCSP would need a 12 per cent drop in expected revenue or a 15 per cent rise in budgeted costs, or a combination, for it to start making losses. In the longer term, the business model depends on MyCSP winning new business to cover its costs over the contract period. But MyCSP is unlikely to win significant large contracts until it has transformed its own operation. Furthermore, it currently does not have any quality accreditation (ISO 900), which is a common industry standard. It needs this along with business continuity arrangements before it can compete for new work.

**3.5** We reviewed the contractual documents for the protections to the Department and the taxpayer if risks should crystallise. The contracts cover the standard protections for a transaction such as this, with further protections through the Department's shareholding (key protections and explanations are set out in **Figure 12**). The transaction's success will, however, depend on the quality of the contract management and in the transparency of financial and operational data. This is an issue on which we have reported on a number of previous occasions. In the event of catastrophic failure of MyCSP, Equiniti's Paymaster's (Paymaster) liability is limited to its equity, valued at £15.5 million at financial close, and the services it provides to MyCSP over the remaining life of the contract. It would, however, also suffer reputational damage in its core area of business.

## Operational progress since spinning-out

**3.6** MyCSP started trading as a commercial enterprise on 1 May 2012. The business was ready to operate and the company began trading from day one, providing continuity of service to scheme members.

### Financial performance

**3.7** Revenue in the first nine months of operations has been much lower than anticipated. MyCSP relies on two principal sources of income: administering civil service pensions; and administering redundancy payments. While the pensions' income is fixed in the contract, the income from redundancy payments depends highly on the level of redundancies. MyCSP accepted the risk associated with this variable income as part of the transaction. MyCSP's business plan reflected in the Department's business case, projected £5 million of income from redundancies, 14 per cent of the total, in its first year. This was based on servicing 70,000 redundancies. However, MyCSP's full-year projection is now 92 per cent lower at just above 4,000, with a resulting reduction of £4.7 million of income. MyCSP does not earn any revenue from civil servants who leave the service voluntarily rather than through redundancy. MyCSP expects the level of redundancies to now be no higher than 20,000.

**3.8** MyCSP has responded quickly to the shock of much lower than anticipated revenues. It has brought forward its voluntary redundancy programme, releasing 43 staff, around 8 per cent of its workforce, in November 2012. It froze any recruitment of additional staff for compensation work, and insourced work that was previously contracted out. MyCSP made a profit of £1.7 million for its first year, just over half of the business case budget of £3.1 million. It has also identified around £264,000 of new work in year one, which was not anticipated in the original business plan.

## Figure 12

Taxpayers have a number of protections from failure

- **Gainsharing** – profits in excess of 2 per cent of those envisaged are shared equally.
- The Department can **benchmark** MyCSP's costs to ensure they are reasonable.
- **Service credits** are provided for where service falls below the contract.
- MyCSP will provide **transparent** cost information, and the Department is represented on the board through its non-executive director.
- The contract has **termination for convenience** provisions.
- The Department may be able to exercise influence through its **35 per cent shareholding** and will share in any capital gain.
- The contract has **step-in rights** after protracted non-performance.
- Paymaster has agreed to a **non-compete clause**, which means that it will not bid against MyCSP for contracts in public sector pensions administration.

Source: National Audit Office analysis of Department data

### Staff continuity

**3.9** The Department and MyCSP have experienced high turnover in key positions. This has created a loss of continuity and has limited knowledge transfer and the capturing of lessons learnt. There have been three programme directors since the decision to spin-out. The head of the scheme management executive (SME), a key person in contract negotiations, left three months after the contract was signed. MyCSP's finance director left on the first day of operation, as planned, and the chief executive officer, who was the original head of the programme, left seven months later, followed by the chief operations officer at the end of the company's first year, leaving just one person from the original senior management team. The loss of experience and continuity is compounded by the fact that the group who designed the transaction and understood the rationale was small. This has created a problem in transferring knowledge from those who designed the business transformation. For example, the new team had to unpick elements of the financial model during the re-pricing negotiations.

### Employee engagement

**3.10** Early results from the employee survey indicate a higher level of engagement and commitment from MyCSP's employee-owners (**Figure 13** overleaf). Fifty-nine per cent of staff value being an employee-owner rather than just an employee, and 52 per cent would recommend MyCSP as a great place to work, more than double the previous year's number of 24 per cent. Staff members' viewpoints on the quality of leadership suggests clear improvements. There was a threefold increase (to 60 per cent) in the number of staff believing that senior leaders have a clear vision for the future of the business. However, staff feel less positive about opportunities to do interesting work, and accessing the right learning and development opportunities.

## Figure 13
MyCSP has surveyed staff views

| DWP staff survey | 2011 (%) | MyCSP survey | 2012 (%) | Change (%) |
|---|---|---|---|---|
| **My work** | | | | |
| I am interested in my work | 79 | I have the opportunity to do interesting work | 53 | -26 |
| **Line management** | | | | |
| My manager is open to my ideas | 68 | My immediate line manager listens to my views and is open to my ideas | 82 | 14 |
| The feedback I receive helps me to improve my performance | 56 | My immediate line manager helps me to perform better | 72 | 16 |
| **Learning and development** | | | | |
| I am able to access the right L&D opportunities when I need to | 49 | I am able to access the right L&D opportunities when I need to | 33 | -16 |
| **Inclusion and fairness** | | | | |
| I feel valued for the work I do | 49 | I value being an employee-owner rather than just an employee | 59 | 10 |
| **Resources and workload** | | | | |
| I have the tools I need to do my job effectively | 60 | I have the right tools and equipment to do the job | 47 | -13 |
| I achieve a good balance between my work life and my private life | 61 | I achieve a good balance between my work life and my private life | 71 | 10 |
| **Pay and benefits** | | | | |
| I feel my pay adequately reflects my performance | 21 | I am adequately rewarded for the work that I do | 40 | 19 |
| **Leadership and managing change** | | | | |
| I believe that senior leaders have a clear vision for the future of the organisation | 21 | I believe that senior leaders have a clear vision for the future of the business | 60 | 39 |
| I have confidence in decisions made by senior management | 16 | I have confidence in senior leaders | 53 | 37 |
| **Engagement** | | | | |
| I would recommend MyCSP as a great place to work | 24 | Would you recommend MyCSP as a great place to work? Yes | 52 | 28 |

Source: MyCSP

## Re-pricing the contract

**3.11** The re-pricing of the contract for transformation has now been agreed and is at the top end of the range set out in the original contract. Furthermore, there are two groups of additional items. These relate to errors uncovered in the data underpinning the original contract, and further work outside of the original contract. **Figure 14** details these costs.

**3.12** The negotiations over the re-pricing took three months longer than the six months allowed for in the contract, and the contract was finally agreed on 21 March 2013. The delays were due to the negotiations over MyCSP's proposed new pricing taking four months rather than the unrealistic contractual period of 30 days.

### Figure 14
Costs increased in the re-pricing of the contract

| | Explanation | Cost (£000) |
|---|---|---|
| Contractual transformation costs | | |
| Cap of 5 per cent on contract charges | Costs from years four to seven to transform the service and within the 5 per cent cap | 5,447 |
| Year 3 additional costs as a result of delaying transformation by one year | The old infrastructure will need to be run for an additional year | 3,986 |
| Contractual variations | | |
| Management information | SME requested an improved system for management information, which was additional to the original contract but helps to achieve the delivery of 2015 career average changes | 1,382 |
| Extra contract costs arising from errors | | |
| Calculations and manuals | MyCSP as a public entity failed to deliver the necessary specifications | 704 |
| Dual running | Invalid assumptions in the business case that no dual running of old and new systems would be necessary | 1,019 |
| **Total** | | **12,538** |

Source: National Audit Office review of Department data

## Realising the benefits

**3.13** This deal is intended to have benefits for a number of different stakeholders. We have set out the benefits below, with a commentary on how far benefits have been realised.

### The Department as customer

**3.14** The responsibility for ensuring value for money from service delivery falls to the SMB. Very soon after spinning-out the key contract manager moved on, which together with the changes in MyCSP's management have led to a loss of knowledge transfer and continuity. The new contract management team has found that the payment mechanism may protect members better as it is supported by financial penalties. However, it has proved unworkable to date. The number of indicators increased from eight to 162 in the early part of the contract. However, the IT infrastructure to support improvements or measure service quality was not in place, and is not projected to be fully functional until three years into the contract. The board considers it unrealistic to expect MyCSP to deliver to a very high specification before it has had time to remedy the problems inherited from the legacy organisation, and has agreed an improvement plan with MyCSP.

### Government departments as suppliers

**3.15** Government departments supply MyCSP with property and facilities (10 per cent of MyCSP's cost base currently, although MyCSP will move off the government estate) and the input data for MyCSP's operation. Departments are therefore important parties in ensuring the quality of MyCSP's output. The data that some government departments supply is still very poor. The Department's Internal Audit found that 'some' of the data handed over to MyCSP is inaccurate. For example, some employers do not understand how their payroll provider transfers data to MyCSP. The audit found examples of incomplete member service records, although it has yet to quantify the problem. The internal audit is ongoing.

**3.16** MyCSP can reject faulty data and send it back to the government department, which stops the clock on service credits. There is therefore some potential for MyCSP to game the system. Also, there are no service level agreements between government as supplier and MyCSP.

### The Department as owner

**3.17** As a 35 per cent owner of MyCSP the Department must attain value for money from its shareholding. The shareholding is held by the HM Treasury solicitors, which acts according to the Department's instructions. The duty to shareholders is discharged by having a non-executive director on MyCSP's board. This means that the Department has access to important financial and operational data from MyCSP with which it can track the organisation's progress. However, a non-executive director has a fiduciary duty to the company and not to the Department. This means that the same individual has to act for both the company and the taxpayer. To guard against any potential conflict of interest between his duties to the company and the taxpayer, the Department's finance director can potentially step in to represent the shareholder interest.

## The Department as pathfinder sponsor

**3.18** A large element of the value-for-money proposition of this transaction is its status as a pathfinder. The Department has a high level of transparency of MyCSP's operation because it is a shareholder and is represented on the board. It is also tracking the staff survey. The Major Project Authority's review found no defined methodology for tracking the programme benefits. The Department has now developed an evaluation strategy that covers the key aspects of MyCSP's performance. This includes the measurement of productivity benefits by comparing the number of employees per scheme member to industry averages. There are no comparative data specifically for public sector productivity currently available, hence the perceived value to the Department of proceeding with a pathfinder.

**3.19** An important role in this pathfinder is dissemination of the good practice and lessons learnt. However, our review has found that there is no consistently applied system for knowledge or document management. The Department's audit and risk committee encountered problems accessing key information during its own review, and we have also encountered difficulties in particular with access to ministerial submissions, which are important records of key ministerial decisions, being problematic.

## Future risks

**3.20** The civil service pension changes of 2015 will require MyCSP to collect and manage much more data. The spinning-out of MyCSP means that the Department will lose some competitive tension in securing the administration of the scheme. However, it is extremely unlikely that, given the state of MyCSP's infrastructure, it would have been able to service the new arrangements without transformation. MyCSP reports being on schedule to deliver the transformation needed for 2015, and it is working with the Department to improve the quality of payroll data supplied by government. The extended negotiations on transformation mean that there is no room for slippage if transformation is to complete in time for the 2015 scheme.

**3.21** The private sector partner has seconded more staff than it anticipated into MyCSP to support the new IT infrastructure, and because the business plan only allowed for generalist staff where specialists were required. The CEO originally intended to work three days a week for the organisation but will now be working full-time. There will be a critical period when current secondments end, meaning that knowledge transfer now is vitally important.

# Appendix One

## Our audit approach

**1** This study examined the spinning-out of MyCSP as a mutual joint venture and whether it will enable value for money to be achieved. We reviewed:

- The current level of value for money offered by MyCSP and how well the Department appraised the alternative options for transforming it.
- How well the Department prepared for and executed the transaction.
- How well MyCSP has performed to date, whether the benefits are being realised and the risks to longer-term success.

**2** We applied an analytical framework with evaluative criteria, which consider what arrangements would be optimal for spinning-out a mutual joint venture from the public sector. The evaluative criteria have been developed by drawing on the National Audit Office's previous work on asset sales, privatisations and commercialisations. The evaluative criteria focused on five broad categories:

- **Pricing and information** – Did all parties to the deal have the relevant information and expertise to price and structure MyCSP in support of value for money?
- **Corporate structure and governance** – Did the corporate structure and governance of MyCSP align with achieving value for money?
- **Risk transfer** – Is risk transfer to MyCSP partners optimal and aligned with value for money?
- **Benefit realisation and public interest** – Were benefit realisation and the public interest robustly considered?
- **Market strategy and oversight** – Is there a clear strategy for oversight of the market in which MyCSP is operating?

**3** Our audit approach is summarised in **Figure 15**. Our evidence base is described in Appendix Two.

## Figure 15
Our audit approach

**The Department's objective**

MyCSP needed transformation because its IT was not fit for purpose, its costs were high and it had a high error rate in making payments. The Department considered that it needed a quick and innovative approach, and cash injection to fund business transformation because of the lack of available public sector funding coupled with a need to secure savings and improvements in customer service.

**How this will be achieved**

In April 2011, the Department commenced its decision to spin-out MyCSP as a mutual joint venture. The Department wanted the investment in infrastructure and expertise that a private sector partner could bring to help transform the business, and identified MyCSP as ripe for testing its policy of promoting consideration of a wider range of alternative delivery models.

**Our study**

The study examined whether the Department has secured value for money to date from spinning-out MyCSP, and the remaining risks to value for money.

**Our evaluative criteria**

- Did all parties have relevant information and expertise to price and structure MyCSP in support of value for money?
- Did the corporate structure and governance of MyCSP align with achieving value for money?
- Is risk transfer to MyCSP partners optimal and aligned with value for money?
- Were benefit realisation and the public interest robustly considered?
- Is there a clear strategy for oversight of the market in which MyCSP is operating?

**Our evidence**

(see Appendix Two for details)

We reviewed key MyCSP programme documents.

We interviewed key figures in the Department, private sector partner bidders and consultants.

We reviewed key programme documents, Department Audit Committee and SMB meeting minutes, and internal audit's post-transaction review and the Major Project Authority's (MPA) early review of the programme.

We interviewed key figures in the Department, SMB, bidders, MyCSP and legal advisers.

We interviewed key figures in the Department, SMB, MyCSP and the legal advisers.

We reviewed key programme documents, MyCSP management reports and employee survey results, and the supply contract.

We conducted an indicative analysis of the public sector pension administration market.

**Our conclusions**

The spinning-out of MyCSP has potential to deliver good value for money with a projected 25 per cent reduction in costs to the Department and service improvements for members. Given poor data quality, planning and infrastructure and the forthcoming 2015 pension changes, government will need to remain actively engaged as customer, shareholder and supplier to ensure risks do not revert back to government and to capture fully the potential benefits of the deal.

The Department did not initially optimise the opportunities to learn from this transaction as a pathfinder. The Department must press on with evaluating the longer-term comparative performance of MyCSP, and capture and disseminate the lessons learned from running the transaction.

# Appendix Two

## Our evidence base

**1** Our independent conclusions on whether the spinning-out of MyCSP will enable value for money to be achieved were reached following our analysis of evidence collected between October 2012 and April 2013.

**2** We applied an analytical framework with evaluative criteria, that consider what arrangements would be optimal for the spin-out of mutual joint ventures from the public sector. Our audit approach is outlined in Appendix One.

**3** We assessed the degree to which all parties to the deal had the relevant information and expertise to price and structure the spin-out in support of value for money:

- We reviewed key MyCSP programme documents including the outline and full business cases for spinning-out MyCSP and the underlying financial model, for the level and robustness of information provided to aid pricing and structuring of the deal. We also reviewed Scheme Management Board (SMB) minutes to ascertain the risks and issues concerning the deal and how these were addressed.
- We reviewed key documents concerning the procurement of the private sector partner bidder including submissions from the four shortlisted bidders and the Department's bid evaluation reports to understand the bidders' pricing of the share in MyCSP and the Department's assessment and final decision on the winning bidder.
- We interviewed key figures in the Department, private sector partner bidders and consultants to determine their views on: the information and assumptions used to price and structure the deal; the level of relevant expertise within the Department and MyCSP to effectively complete the deal; and the level of awareness and understanding of key business risks and how these were mitigated.

**4** We assessed whether the corporate structure and governance of MyCSP aligned with achieving value for money:

- We reviewed the outline and full business cases, and supporting documents to understand: how the Department decided on the mutual joint venture option over the alternatives; and the subsequent shareholding levels for the Department, the employees and the private sector partner.

- We reviewed the Department's Audit Committee meeting minutes, the Department's Internal Audit post-transaction review and the Major Project Authority's (MPA) early review of the programme to understand issues concerning the MyCSP programme including the governance arrangements for the deal and how the Department was addressing them.
- We interviewed key figures in the Department's programme team, SMB representatives, shortlisted bidders and the MyCSP senior management and employee representatives. The purpose of the interviews was to understand the decision-making and issues around the choice of the mutual joint venture model, the corporate structure of MyCSP and the governance arrangements.

**5** We examined whether the risk transfer to MyCSP partners is optimal and aligned with value for money:

- We reviewed the supply contract between the SMB and MyCSP to understand the allocation of risk to the Department and MyCSP.
- We interviewed key figures in the Department's programme team, the SMB, the bidders, MyCSP and the legal advisers on the deal to understand the risks being transferred and the capacity of the partners in MyCSP to manage these risks.

**6** We assessed whether benefit realisation and the public interest was robustly considered:

- We interviewed key figures in the Department, SMB and MyCSP to understand the intended benefits for the spin-out and how these will be achieved, including how the Department plans to learn from this 'pathfinder' transaction and share lessons more widely.
- We interviewed legal advisers on the deal to understand the protections afforded to the Department and the taxpayer in the event of failure.
- We reviewed the outline and full business cases and previous reviews of the MyCSP pension administration arrangements to understand the intended benefits and history behind MyCSP's planned transformation.
- We reviewed MyCSP management reports and employee survey results to understand early progress since the spin-out of MyCSP. We also reviewed the MPA's early review of the programme to understand points concerning benefits realisation.
- We reviewed the supply contract between the SMB and MyCSP to understand the legal protections in case of MyCSP failing.

- We conducted an indicative analysis of the public sector pension administration market to understand how efficient MyCSP was compared with other public sector schemes. We compared the administration cost per member of different public sector schemes with the number of members in the scheme. We reflected the potential economies of scale by calculating a best-fit curve through regression analysis. We also examined the financial analysis and sensitivity testing conducted by the Department in the business cases.

**7** We assessed whether there is a clear strategy for oversight of the market in which MyCSP is operating:

- We conducted interviews with the key figures in the Department, the SMB and MyCSP to understand the Department's strategy for its role as the customer of, and as a shareholder of, MyCSP.
- We reviewed the outline and full business cases to determine what the Department is hoping to achieve with its equity stake and its planned engagement strategy.

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