



National Audit Office

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## **Report**

by the Comptroller  
and Auditor General

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## **Cabinet Office**

# Transforming government's contract management

## Key facts

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**£40bn**

spent by central government on procuring goods and services, 2013-14 (estimated)

**60**

contracts tested for overbilling

**34**

had issues with billing to some extent

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- 5 contracts** have been referred to the police or the Serious Fraud Office
- £179.4 million** has been paid by G4S and Serco, after identifying overbilling
- 73 contracts** were reviewed against our 2008 framework by the Ministry of Justice, Home Office, Cabinet Office and the Department for Work & Pensions (each contract assessed against 8 areas, a total of 584 assessments)
- 343 out of 584** areas of contract management assessed as weak (of this, 73 were considered to create a material risk of overbilling)
- >100,000** contracts in central government (estimated)
- 4,000 people** commercial specialists across central government (estimated)

# Summary

**1** In November 2013 we set out how government was facing what we described as a crisis of confidence in its contracting of public services. Contracting out services is a useful tool to reform public services and improve value for money. However, we raised questions about competition in the market for government services and whether contractors' returns were transparent and their performance satisfactory. We also showed how government must improve oversight, control and assurance over contracted-out services.

**2** Last year, a series of government contractor and contract management failures emerged. In particular, the Ministry of Justice announced in July 2013 that it had found significant overbilling in its electronic monitoring contracts with G4S and Serco dating back to 2005. The Ministry commissioned further reviews of their other contracts and the Cabinet Office did the same for the major G4S and Serco contracts across government. The Home Office and the Department for Work & Pensions also commissioned internal reviews of contracts with a range of contractors. In total, central government tested 60 contracts for overbilling and 73 for contract management practice.

**3** The reviews found widespread problems in administering government contracts, including poor governance, record keeping and capacity issues. These findings echo our work on contracts and contract management dating back to 2006. The reviews recommended how the new Crown Commercial Service (CCS) and departments could improve contract management.

## Scope of this report

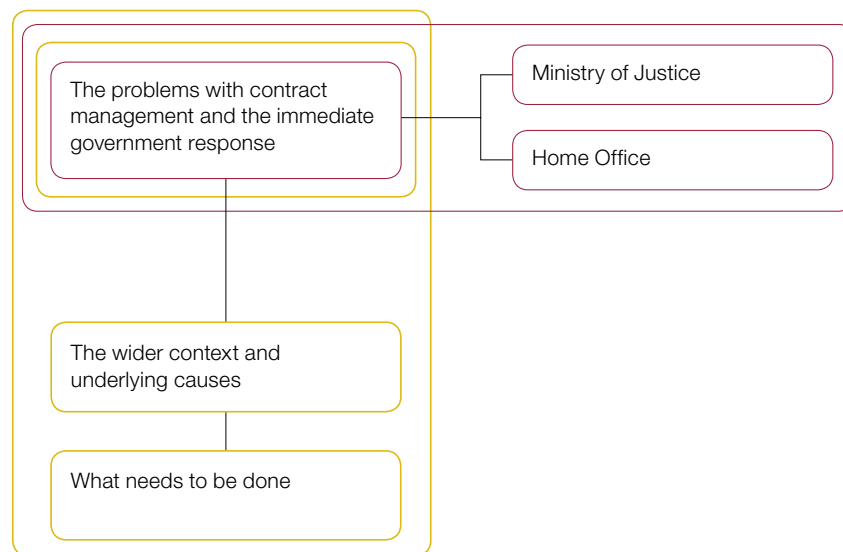
**4** This report looks at how government has responded to the findings about its weak contract management in its procurement of services:

- **Part One**  
Sets out the findings of the government reviews and government's response.
- **Part Two**  
Sets out the wider context and underlying causes of weaknesses in contract management.
- **Part Three**  
Sets out our view of the way in which contract management needs to change, building on current government initiatives.

5 We are publishing an accompanying report: *Transforming contract management in the Ministry of Justice and the Home Office*. This shows a detailed example of these reforms and challenges in practice (**Figure 1**).

### Figure 1

Our two reports on contract management



- Cross-government report: High-level findings across government
- Home Office and Ministry of Justice report: What this means for Home Office and Ministry of Justice

Source: National Audit Office

## Key findings

### Response to overbilling

6 **The Cabinet Office, HM Treasury, and the Ministry of Justice reacted strongly in handling G4S's and Serco's overbilling.** However, government was constrained in its actions and acted as if the firms were too important to fail: their failure could create widespread disruption to public services and government wanted their ongoing participation in competitions. They referred both companies to the Serious Fraud Office (SFO), whose investigations are still ongoing. They demanded that both companies change, and both companies proposed formal processes of 'corporate renewal'. These included changes to management, organisational structures, ethical training and controls. There was no official ban on letting new contracts to the companies, but departments had to get the Minister for the Cabinet Office to approve new contracts and the companies withdrew from several tender processes.

**7 Government secured payments of £179.4 million from the contractors related to overbilling issues.** Government negotiated payments of £104.4 million from G4S and agreed £68.5 million from Serco covering rebates, investigation costs and interest relating to the overbilling on electronic monitoring. Following reviews of further contracts, G4S paid government £4.5 million in respect of billing issues on 2 court facilities management contracts, which were also referred to the SFO. Serco paid £2.0 million relating to its prisoner escorting and custodial services contract, which has been referred to the City of London Police.

**8 Government's reviews provided evidence of further billing or reporting errors across government contracts, though no evidence of deliberate wrongdoing.**

The government reviews were thorough, but only 60 central government contracts were tested for overbilling, of which some 34 had issues in the amount billed. These issues included both under- and overbilling. Given the flaws in contract management controls across government, it is in our view probable that other instances of overbilling have occurred across government's wider contract portfolio. We cannot be sure of the extent of such overbilling or whether it is material.

## Problems with contract management

**9 The reviews found widespread problems with how government manages its service contracts.** As well as testing for overbilling, 73 contracts were tested against the 8 areas of the NAO's 2008 good practice framework for contract management.<sup>1</sup> Issues were found on all 8 areas, for example:

- **Planning and governance (issues on 38 out of 73 contracts tested)**  
Departments lack visibility of contract management at board level and lacked senior-level involvement.
- **People (40 issues)**  
Government does not have the right people in the right place for contract management. There were gaps between the numbers and capability of staff allocated to contract management and the level actually required.
- **Administration (39 issues)**  
Contract management is not operating as a multi-disciplinary function. There was often limited interaction between finance, commercial and operational contract management functions.
- **Payment and incentives (48 issues)**  
Government is not fully using commercial incentives to improve public services. Levels of payment deductions allowed by contracts are often insufficient to incentivise performance. Open-book clauses were rarely used.

<sup>1</sup> National Audit Office, *Good practice contract management framework*, December 2008.

- **Managing performance (50 issues)**

Contractual performance indicators are often weak and government is too reliant on data supplied by contractors.

- **Risk (47 issues)**

Government does not have sufficient understanding of the level of risk it is retaining on contracted-out services. None of those in the cross-government review shared risk registers with the contractors to ensure all understood who was managing what.

- **Contract development (50 issues)**

Departments are paying insufficient attention to the impact of contract change. For example, departments made changes at operational level in isolation from other service areas. Systems for maintaining up-to-date versions of contracts remain weak.

- **Managing relationships (31 issues)**

Not all departments have had a strategic approach to managing supplier relationships. Senior management engagement with suppliers has not been widespread across government. A lack of meaningful incentives for innovation can inhibit shared approaches to problem solving and service improvement.

**10 Poor contract management is a long-standing issue.** By the middle of the last decade there was a large number of mature contracted-out services across government. Our work started to highlight widespread problems with contract management. In our 2008 cross-government report on the management of service contracts we said that no commercial director or head of procurement rated the resources allocated to managing major contracts as 'good'. We highlighted poor risk management, inadequate performance measurement and limited use of performance incentives.<sup>2</sup> Since then, we have reported on many contracts with weak contract management. These weaknesses have far-reaching consequences, including:

- **Fraud and error**

For instance, better scrutiny of payments and understanding of the contract could have prevented the overbilling found in the Ministry of Justice's contracts referred to authorities.

- **Not managing risk**

For instance, the Ministry of Defence's failure to provide ICT infrastructure critical to the success of the Army's recruitment contract with Capita impacted on recruitment activities and increased costs.<sup>3</sup>

2 Comptroller and Auditor General, *Central government's management of service contracts*, Session 2008-09, HC 65, National Audit Office, December 2008.

3 Comptroller and Auditor General, *Army 2020*, Session 2014-15, HC 263, National Audit Office, June 2014.

- **Risk of contractual dispute**

For instance, ambiguities in the Home Office's immigration removal centre contracts meant that disagreements were difficult to settle.<sup>4</sup>

- **Performance deductions are not always enforced**

For instance, the Home Office did not enforce penalties for defects in asylum seeker accommodation as it felt that the contracts were at an early stage.<sup>5</sup>

- **Not understanding how contracts meet policy objectives**

For instance, poor senior oversight meant the risk profile on the Department for Work & Pensions' Work Programme was changed in the contractors' favour.<sup>6</sup>

- **Use of commercial levers**

For instance, pressures to find cost savings led HM Revenue & Customs (HMRC) to trade away some of its negotiating power and hindered its ability to get strategic value from its long-term Aspire ICT contract. When negotiating cost savings in response to successive funding settlements, HMRC conceded many of its commercial safeguards through major renegotiations of the contract between 2007 and 2009, including the right to share in supplier profits when they were higher than target and the right to compete services. HMRC estimates it achieved savings of £750 million through such negotiations. Since 2012, HMRC has negotiated some of these commercial controls back.<sup>7</sup>

**11 Previous attempts to improve contract management have not delivered sufficient change.** Government has sought to improve its general commercial capability since the early 1990s, most notably with the Gershon reforms from 1999 and the more recent efforts by the Cabinet Office. We published a good practice framework for contract management with our 2008 report<sup>8</sup> and the Committee of Public Accounts recommended how to improve contract management in 2009. The Office for Government Commerce (then part of HM Treasury) accepted this, but it failed to influence departments and focus drifted away. More recently, the Cabinet Office has focused on using government's collective buying power to make savings, rather than improving individual departments' contract management.

4 HM Government, *Cross Government Review of Major Contracts*, December 2013.

5 Comptroller and Auditor General, *COMPASS contracts for the provision of accommodation for asylum seekers*, Session 2013-14, HC 880, National Audit Office, January 2014.

6 Finding from cross-government review.

7 Comptroller and Auditor General, *Managing and replacing the Aspire contract*, Session 2014-15, HC 444, National Audit Office, July 2014.

8 National Audit Office, *Good practice contract management framework*, December 2008.

**12 The underlying causes of problems in contract management go beyond poor administration and lapsed awareness.** Although it is difficult to generalise across 17 departments, from our collective experience of looking at government contracts, we have identified 4 root causes of these problems with contract management:

- **Government fails to recognise the value of contract management.** The purpose of contract management is to use commercial mechanisms to improve services and reduce costs. Too often contract management has been seen as delivering the deal that was agreed when the contract was signed. This has meant that contract management has been seen as a way to avoid things going wrong, rather than unlocking value. Government needs to recognise that value is achieved over the life of the contract. This means designing policies it has the capability to deliver, planning for the contract management stage earlier, and paying it more attention.
- **Senior managers in central government departments have not taken contract management seriously.** Central government has yet to adapt to the commissioning role it aspires to. Departments have not adapted governance to the expanding role of government contracting: they have lacked the basic infrastructure of oversight, senior engagement, challenge and scrutiny. Systems of governance have focused on approving new projects, as if government's responsibility ends when the contract is signed.
- **Senior managers have not demanded visibility over their contracts.** Senior managers have not always acted as if they recognised that departments are responsible and carry the risk for the services they have contracted. Managers have rarely demanded combined portfolio information to scrutinise and challenge operational contracts. Senior managers have often only engaged on contracting issues to firefight problems. As a result, they have put little pressure on teams to improve the information they rely on to manage the contract.
- **Government has a permanent disadvantage in commercial capability.** There have been many initiatives aimed at improving commercial capability in the past and more improvement is possible. Traditionally, the procurement profession has had a low status in the civil service, while contract management has been seen as low status within the procurement profession. Cabinet Office estimates government as a whole deploys less of its specialist commercial resources on contract management than the private sector. The profession has lacked the sway over colleagues to implement good practice, and struggled to attract the best talent and skills. Furthermore, without a way to measure the value of this deployment, contract management has been vulnerable to administration cuts and under-investment. Yet it is doubtful that the government can improve its capability to be able to have the best contract managers on all its contracts. It will not pay either to bring in or retain commercial experts to match the combined expertise of its contractors.



## Government's response

**13 The Government is taking the findings of contracting problems very seriously.** Since autumn 2013, accounting officers and senior commercial officials have met regularly to oversee the reviews and the resulting change programmes. The group is known as 'Markets for Government Services (Officials)' (MGS(O)) and is led by the Head of the Civil Service and the Cabinet Secretary. The group is coordinating government's strategic response including market development, contingency plans for supplier failure and transparency (**Figure 2**). Its focus on contracting provides a window of opportunity to embed a sustainable change in how government manages providers.

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### Figure 2

#### The government's response

The government, led by the 'Markets for Government Services (Officials)' group has taken the findings very seriously. In response it has:

- Secured payments of £179.4 million from G4S and Serco related to overbilling issues. They also demanded that both companies change, and both companies proposed formal processes of 'corporate renewal'.
- Undertook a number of reviews across government to test for overbilling and assess the quality of contract management.
- Asked all departments to put in place plans to improve their contract management. These change programmes are currently underway.
- Launched commercial capability reviews to test how far departments have embedded changes.
- Increased its focus on some of the underlying issues, by:
  - Examining how government can maintain and further develop competitive markets for government services, to encourage new entrants through both overall market design and specific procurement competitions.
  - Starting to work with independent groups such as the CBI to review the transparency around procurement competitions, ongoing contract performance and the use of open book.
  - Starting to test departments' contingency planning so government is better-placed to deal with supplier failure.
  - Improving data on government's strategic suppliers and managing its relationships more strategically as a single customer through the use of crown representatives.
  - Further reforming the public procurement process to speed up procurement and make procurement more accessible to SMEs.
  - Improving government's overall commercial capability through the establishment of the crown commercial service and initiatives to improve commercial recruitment, training and development.

Source: Interviews with officials and review of MGS(O) papers

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**14 Departments have launched significant change programmes to improve how they manage contracts.** The Cabinet Office asked all departments to put in place plans to improve their contract management by February 2014. All accepted the need to improve. Our accompanying report looks in detail at the changes under way in the Ministry of Justice and the Home Office. Together with the Department for Work & Pensions and the Ministry of Defence, they are the most advanced in their change programmes. The Cabinet Office and HM Treasury are undertaking commercial capability reviews on departments to test how far departments have embedded these changes.

**15 The Cabinet Office is also trying to improve its management of common goods and services.** The CCS was launched on 1 April 2014. Departmental commercial staff and responsibility for procuring certain categories of goods and services have already started to move across to the new service. Concentrating commercial expertise in a single organisation is likely to help with general capability constraints. However, moving staff to CCS may make departmental reform more complicated in the short term. Furthermore, the CCS is still developing its own capability, with recent changes to its senior management and governance, and new systems and procedures being introduced to manage contracts.

## Transforming the management of contracts

**16 The current reforms are going in the right direction.** Below we set out the steps we see as important to transforming the management of contracts and how current initiatives are contributing to this.

### Enabling a commissioning approach

**17 Government needs to put in place the systems and processes to enable the effective oversight and management of contracts.** A common understanding of the structures and systems is emerging from the current reforms under way within departments. In particular:

- **Governance**  
Departments are improving their governance of operational contracts. Departments are appointing senior champions for contract management; clarifying senior responsible owners and lines of escalation; and having a senior forum to challenge, scrutinise and oversee working contracts and liaise with strategic suppliers.

- **Basic contract information**

Departments do not have information systems that combine the needs of finance (paying contractors), procurement (planning for and conducting bidding), or contract management (understanding performance, costs, the commercial position and the agreed contract). A few larger departments are still putting in place contract registers. We have yet to see a system that shows departments their current contracts including all changes and contractor communications. The Cabinet Office is setting up a common set of data requirements for government contracts. It will re-launch the Contracts Finder database by October 2014, which is designed to meet procurement needs. It also intends to provide a contractor relationship management system for the new CCS by the end of 2014. However, this plan is undeveloped.

- **Integrated structures**

Departments are taking different approaches to integrating contract management within the business. Some are building end-to-end commercial teams that follow the contract through its life. Others are building specialist commercial teams to focus on each project stage. Some departments are also clarifying how the commercial and operational teams will manage the contract.

- **Integrated processes**

Contract management needs to be integrated into the commissioning process. This means designing policies and contracts with a view to the contract management capability available and any flexibility required. The Cabinet Office has updated its guideline standard operating procedures to ensure contract management is mobilised earlier.

## **Understanding and influencing suppliers**

**18 Government needs to ensure responsibility for the delivery of contracted-out services and the control environment rests with contractors.** Government needs to create a situation where it can rely on its contractors even when it is not deploying its best contract managers to oversee them. Senior executives within contractors should accept, through the contract, the personal accountability for delivery that senior responsible owners accept within the civil service. Such a system would have 3 features:

- **Intelligence on strategic suppliers**

The example of G4S and Serco shows how government needs to be far more inquisitive about the strategy, internal operations and culture of its strategic providers. Where government is reliant on strategic contractors, it is reasonable that it has very clear expectations about how that organisation behaves and manages itself. Information is readily available through sources such as public announcements, investor information and the work of market analysts. Skilled analysis, collation and sharing of this information will improve the intelligence currently provided to the crown representatives who lead cross-government negotiations with strategic suppliers.

- **Transparency**

The Cabinet Office and the Confederation of British Industry (CBI) are working together to produce a joint set of principles for improved transparency over contracting. Internal audit divisions are increasing their work devoted to contract management and starting to think about how to assure the controls for strategic providers. The Department for Work & Pensions, for example, is requiring new contractors to commission external reviews to give assurance on the contractor's controls. These initiatives need to be brought together into an integrated system of control, transparency and assurance. Departments should set out the objectives of the control environment, and use transparency and assurance mechanisms to ensure compliance.

- **Incentives**

Government needs to be better at enforcing its contracts and deducting penalties. We see post-contract audit reviews, gain-share arrangements and profit claw-back playing a greater role in ensuring incentives are aligned and value is not lost in adversarial behaviour. Government and industry now accept that open-book accounting needs to be widely used to build trust and ensure incentives are aligned. However, there are a lot of details to be worked out. The Cabinet Office is undertaking pilots to establish how its regular use will be implemented. This needs to draw on knowledge from departments such as the Ministry of Defence which have experience in this area. We would expect government to develop data analytics to compare costs and margins between contracts.

## **Making the most of limited commercial capability**

**19 Government needs to find ways of making the most of its commercially experienced people.** There needs to be a balance struck between departments retaining sufficient capability to manage their contracts day-to-day and the role of the centre in targeting resources where needed. The Cabinet Office's current initiatives are at an early stage, but are likely to have a positive impact:

- **An enhanced role for commercial staff**

The Cabinet Office and departments recognise that they have focused too much on procurement, and neglected the scoping and operational stages where they can add most value. It is not clear to what extent the current commercial workforce has the right skills. Departments need to consider carefully how they manage any restructuring. However, the new role is likely to be more exciting and influential within the civil service. We hope that it will improve staff engagement and make the profession more attractive to those starting their career or coming from outside the civil service.

- **Central support**

There is a growing central capacity to support departments. The Crown Commercial Service's complex transactions team provides support to departments with complex negotiations or commercial issues. Crown representatives support departments on negotiations with strategic suppliers. Infrastructure UK within HM Treasury provides supports for projects involving private finance. The Cabinet Office is also establishing a common data set for contracts across government (paragraph 17 above) and has issued guidance on how contracts can ensure that procurement information can be shared within government.<sup>9</sup> Better sharing of information on contracts would allow departments and the centre to make better use of a central shared capability.

- **Structured professional development**

Commercial skills are a core part of *The Civil Service Reform Plan*<sup>10</sup> and the accompanying capabilities plan. The CCS is taking on more responsibility for the development and deployment of skills and experience across the profession. It is recruiting centrally for senior posts, setting up a commercial fast-stream and apprenticeship scheme, developing links with universities, putting in place an interchange programme with industry, identifying a framework of skills and experience for staff to attain, and developing core training. Commercial skills also forms part of the Major Projects Leadership Academy syllabus, while departments are also developing their own extra training.

<sup>9</sup> Cabinet Office, *Procurement Policy Note – Information sharing in Government procurement exercises*, available at: [www.gov.uk/government/publications/procurement-policy-note-0114-sharing-information-within-government](http://www.gov.uk/government/publications/procurement-policy-note-0114-sharing-information-within-government), February 2014.

<sup>10</sup> HM Government, *The Civil Service Reform Plan*, June 2012, available at: [www.gov.uk/government/organisations/civil-service-reform](http://www.gov.uk/government/organisations/civil-service-reform)

## **Value for money conclusion**

**20** The government will not get value for money from its contracts until it improves contract management. The Cabinet Office, HM Treasury and major spending departments have recognised the scale of the issue and have responded accordingly. The major spending departments have launched significant change programmes to improve their contract management. The Cabinet Office is strengthening its role in supporting the commercial profession, managing collective spending on common goods and services and supporting departments. We believe this represents an opportunity to bring about needed change. Nonetheless, there is a lot still to be worked out. In our view there needs to be widespread change in the culture of the civil service and the way in which contractors are managed. There needs to be more emphasis on a commissioning approach, transparency over the contractors, use of open-book to align incentives and a targeted focus of the government's commercial capability.

## **Recommendations**

**21** We have set out above the transformation needed in government's management of its contracts. We make 2 recommendations to the centre of government (HM Treasury and the Cabinet Office) aimed at ensuring that these come about:

- a** **The Cabinet Office should set up a cross-government programme to improve contract management, building on the work of the Markets for Government Services (Officials) group.** This will help to formalise existing arrangements and help to make improvement plans more sustainable. Departments' programmes are not joined up and central departments have not coordinated a formal programme, supported by appropriate management techniques. Given the culture change required and the need to sustain efforts across government, the programme should be part of the Major Project Authority's portfolio. The Cabinet Secretary, the Head of the Civil Service and government's Chief Procurement Officer should champion better contract management, especially to senior managers outside the commercial function.
- b** **HM Treasury and the Cabinet Office should continue to use commercial capability reviews to ensure reforms are embedded.** Our 2008 good practice framework gives a reasonable guide to the basic administration and governance every contract needs. The current departmental reforms are creating a common understanding of good practice in the organisational governance, systems and structures, information and capability needed for effective contract management (Figure 5 on page 25). Given current progress, we would expect all departments to have these in place by the end of 2015. The commercial capability reviews should also cover the Crown Commercial Service (CSS). The CCS needs to integrate its contract management processes with these new arrangements within departments. The Cabinet Office should measure the CCS's success by its ability to meet departments' needs.