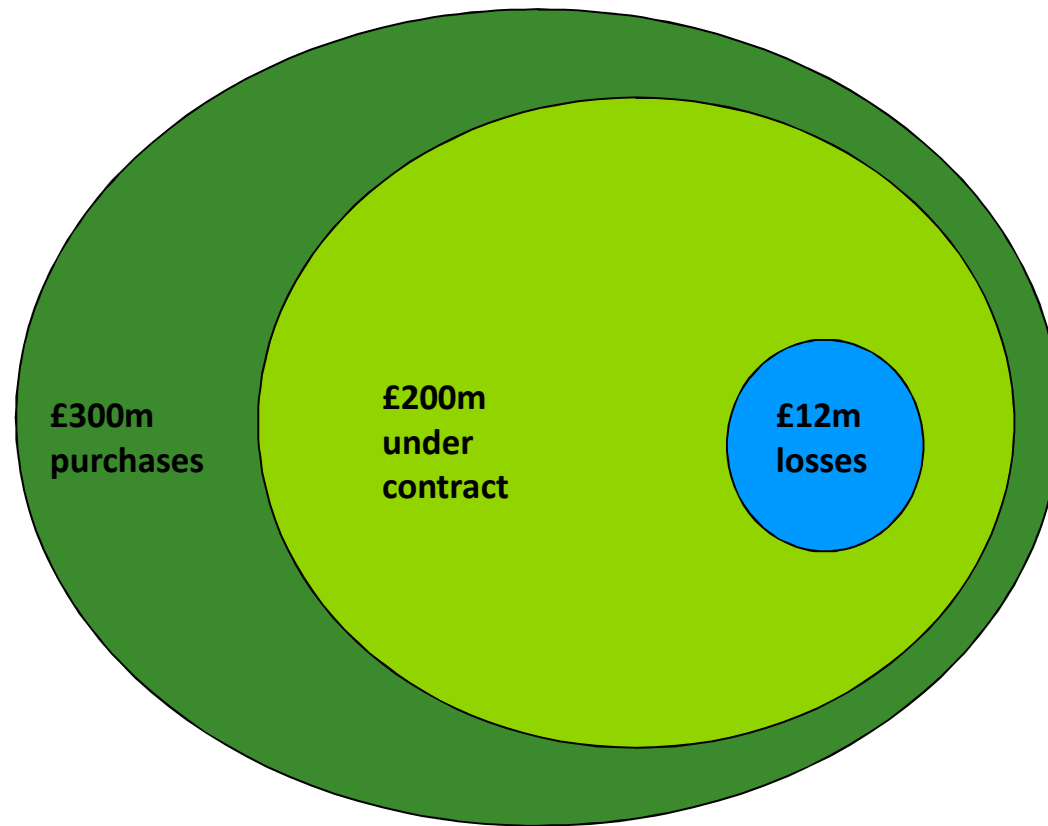


## Managing contract risk in challenging times Turn risk into opportunity

CIPFA North East – October 2010  
David Jackson and Glenn McCauley



# What is the problem?



Source: Aberdeen Group, Contract Management Is the Next Step in Smart Supply Strategy.

# Agenda

Backdrop & challenges

Key relationships – manage or terminate?

Small contracts – inefficiencies that add up!

Wrap up



# Backdrop & challenges

# Why review contract management?

*"Central government pays out to external suppliers many billions of pounds each year for vital support services in such areas as IT and facilities management. But officials are more interested in the process of letting contracts than in managing them afterwards."*

*"The NAO estimates that as much as £300 million could be saved each year if contracts were managed better."*

*"There is a risk that relationships between central government and its external suppliers are too cosy. It is a disturbing finding that, where services being supplied are sub-standard, nearly 40 per cent of departmental contract managers choose not to apply financial penalties to the supplier – even though they are entitled to do so."*

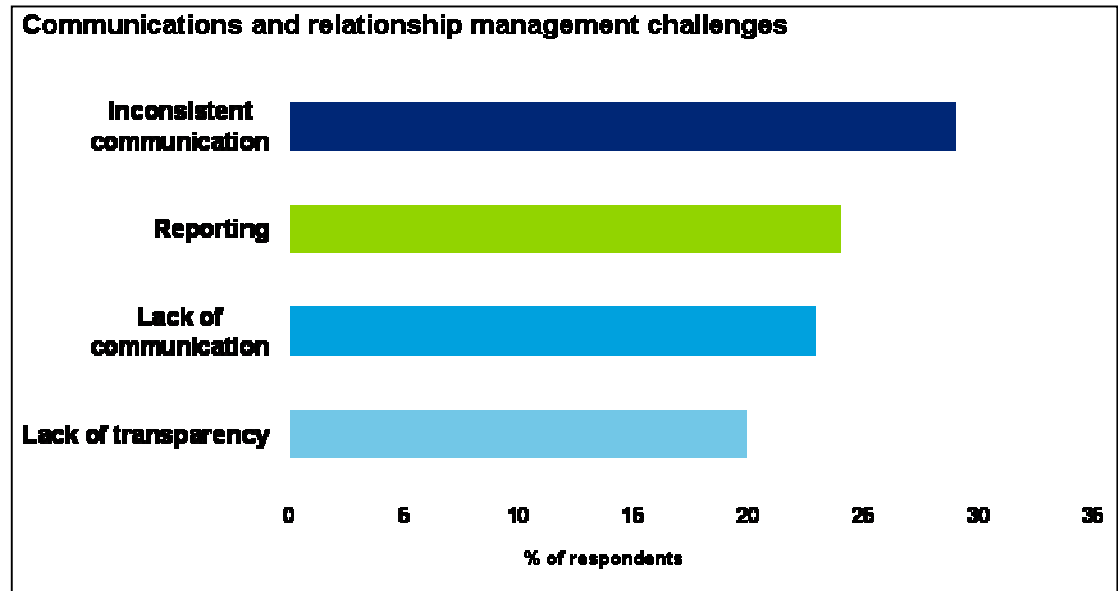
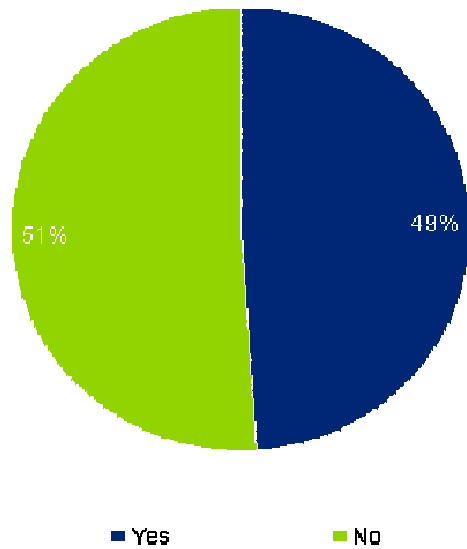
*"Where an outsourced service fails, the effect on citizens can be serious".*

Edward Leigh MP, Chairman of the Committee of Public Accounts (April 2009)

**That's just central government. What about the rest of the public sector?**

# Where do the challenges lie?

## Problems with communication and relationship management



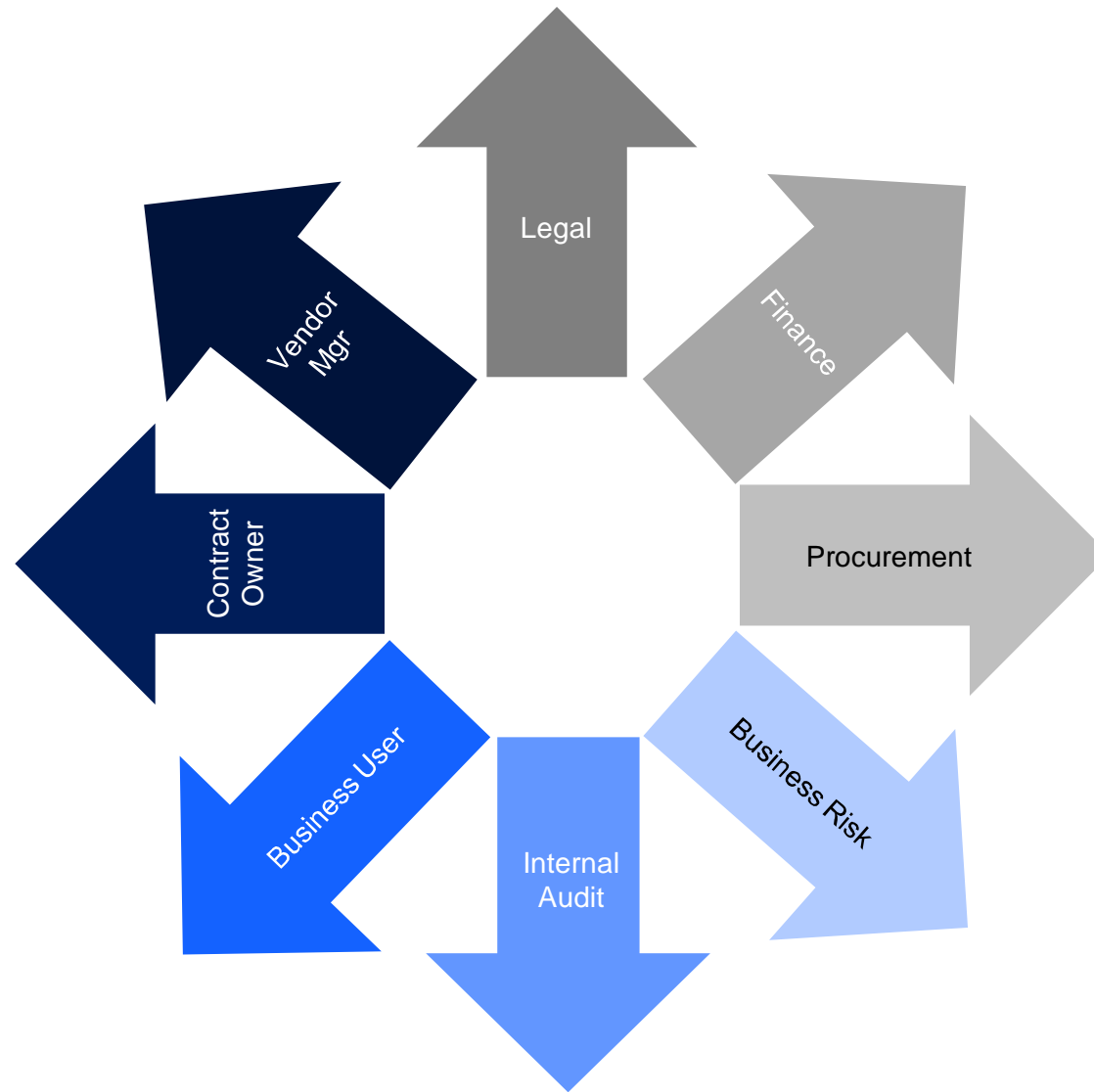
# Whose responsibility is it?

## From the Public Accounts Committee 2009 Report

- Just 2% of value of government service contracts spent on monitoring
- No documented plan for managing 28% of contracts
- 41% of contract managers had not tested the value for money of new services purchased under an existing contract.
- 22% of contract managers considered they did not have time to perform their responsibilities well.
- 60% of organisations did not provide a structured training programme for their staff.

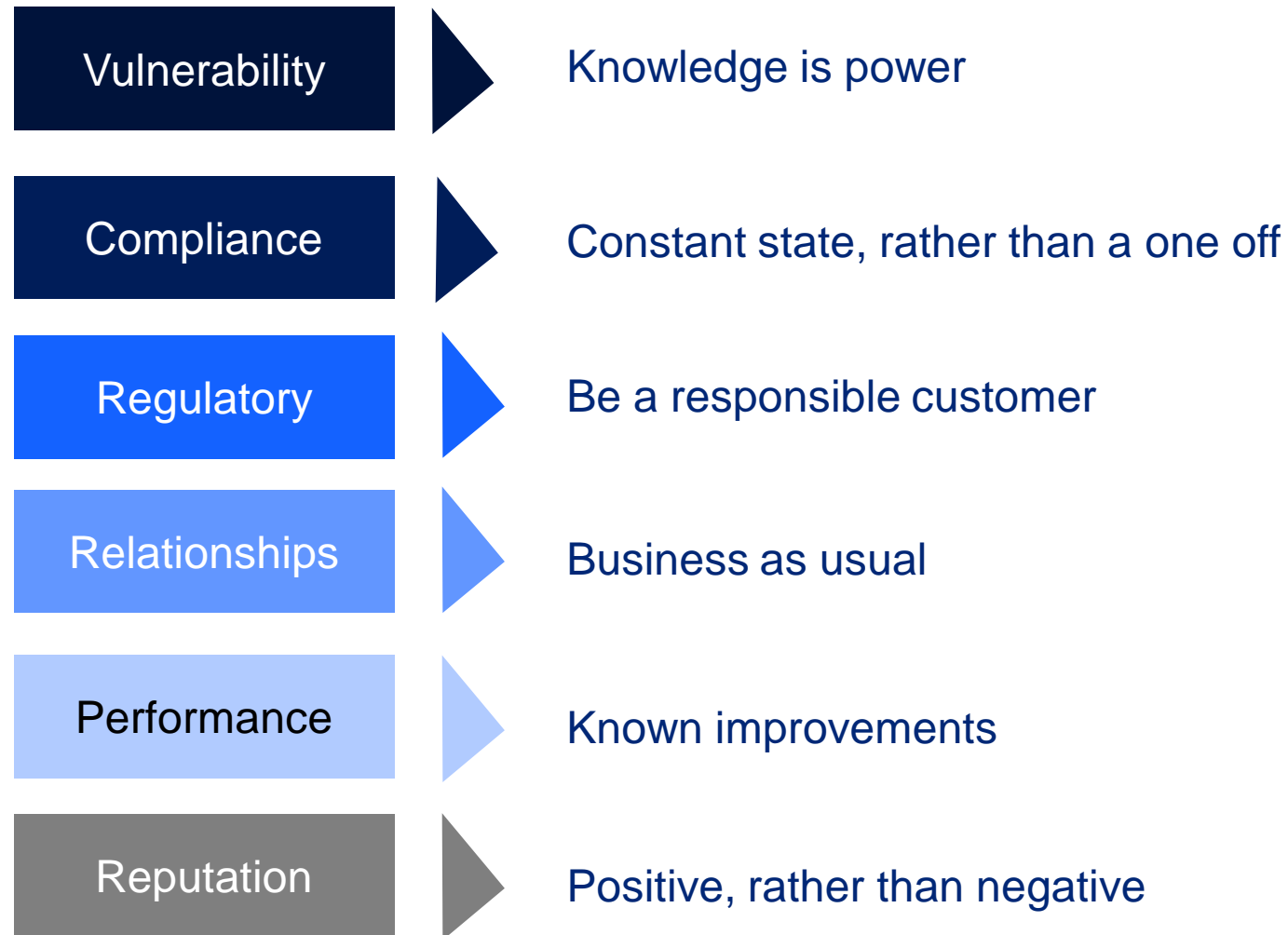
**We cannot afford such a laissez faire approach to the management of VFM**

# Whose responsibility is it?



Your experiences.....

# Where are the opportunities to improve?



# Managing 'strategic' contracts

# Are the contracts being managed?

From the Ipsos MORI research study conducted for Partnerships UK on behalf of HM Treasury: Investigating the Performance of Operational PFI Contracts (2008)

- 74% of contract managers consider that the payment mechanism supports effective contract management

## AND

- 55% per cent say that levying payment deductions led to an improvement in the private sector contractor's performance (23% said it led to a large improvement)

## YET

- 42% of projects had not been subject to any performance or availability deduction over the preceding 12 months

**Proactive contract management appears to improve VFM**

# “Why” Review - Some Specific Review Findings

## From a recent review of an accommodation PFI contract

- Staff were inadequately trained
- On site staff considered contract management the Council’s problem
- The Council had allocated just 10% of a FTE to contract management with no time allocation for inspection
- Limited imposition of deductions even though high dissatisfaction with services
- Third party income is supposed to be shared
  - No reports are produced
  - No income is shared
  - Additional energy costs paid by Council contrary to contract

**What is this costing the authority concerned in service quality and £?**

# “How” Do You Go About A Review - Approach?

*Contractors often seek to enhance their profitability over the course of a contract. Public authorities must be alert to whether this will be at the expense of value for money. There is no simple checklist of things to do to manage such commercial risks. NAO, Private Finance Projects, October 2009*

## Adopt a constructive approach / culture

- Don't treat a review as an adversarial exercise – use it to build relationships / understanding
- Consider independent facilitation
- Involve all key stakeholders – a joint review?
  - Customer / Client
  - Provider(s)
  - Service users
- Successful contracts / relationships rely on:
  - ALL parties fulfilling their obligations (NOT just the provider)
  - Building and maintaining strong personal relationships
  - Effective two-way communication

**Poor relationships and poor performance go hand in hand**

# So “What” Do You Need to Do?

## Stage 1 – Understand the contract

- What is the contract required to deliver?
  - What were the original objectives?
  - How are these reflected in the requirements / service specification?
  - Have objectives changed?
  - Have these been reflected in formal contract variations / change orders?
- How is performance motivated / value protected?
  - How much is payable & how does payment mechanism incentivise?
  - What are the benchmarking / market testing provisions?
  - What are the stated monitoring arrangements?
  - Who is responsible?
  - How are service performance failures supposed to be actioned?
  - What warnings should be issued / deductions made?

# So “What” Do You Need to Do?

## Stage 2 – Understand what is happening in practice

- Are the specified services / requirements provided / met?
  - What do contractor and / or client records show?
  - What do your eyes tell you?
  - What do service users say?

} Does this support the records?
- Is action on performance failure taken?
  - Have warnings been issued?
  - Have deductions been made?
- Have performance management actions led to improvement?
  - Evidence?
- Are benchmarking / market testing provisions enforced / managed?

# So “What” Do You Need to Do?

## Stage 3 – Determine the reason for failings (in any)

- Contractor performance?
  - Lack of / high turnover of staff / other resources?
  - Client-created barriers, e.g. Ineffective management of service interfaces?
  - Client / contractor relationship breakdown?
  - Purposeful action / lack of action to avoid / cut costs?
- Client performance?
  - Training / knowledge of contract?
  - Insufficient dedication / allocation of resources?
  - Laissez-faire attitude / don't want to upset relationship?
  - Ineffective reporting / record keeping?

# So “What” Do You Need to Do?

## Stage 4 – Deliver improvement through value-focused change

- Value benefit of change
  - Assess the cost of lost deduction
  - Assess loss of service benefit
- Put in place action plan commensurate with value benefit
  - Additional client resource / process improvement / technology
  - Increased training
  - Cultural change programme
  - Regular independent review
- Manage benchmarking / market testing processes effectively

## Other issues to consider

### Change in scope

- Can we afford the contract we signed?

### Change in risk profile

- Do we wish to re-negotiate the contract?

### Have you considered the implications of termination?

- Compensation payments and effect on service users

Don't forget the smaller  
'non strategic' contracts!!

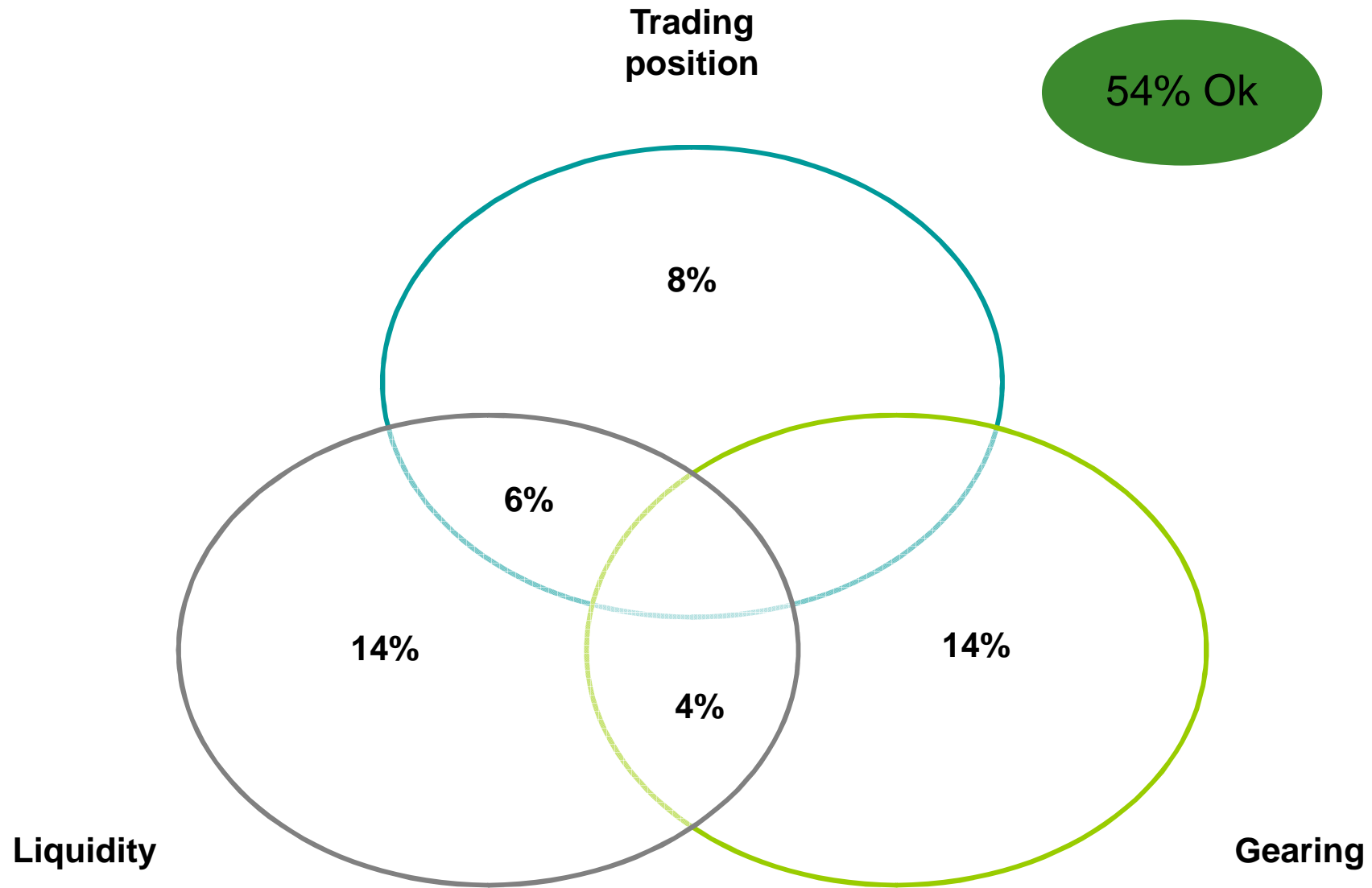
# How can I get assurances efficiently?

Detailed contract review = time = money

- Consider your supplier risk profile
  - Does Procurement talk to the business enough?
  - Are the right questions asked?
- Consider the quality of contract management
  - Does Finance talk to the business enough?
  - How good are your systems and processes?
  - Do you get/give the right management information



# Supplier risk profile – example



## Other things to look out for.....

Fictitious "shell entities"

Schemes that supply faulty or inferior goods

Goods not delivered

Services allegedly performed that were not needed

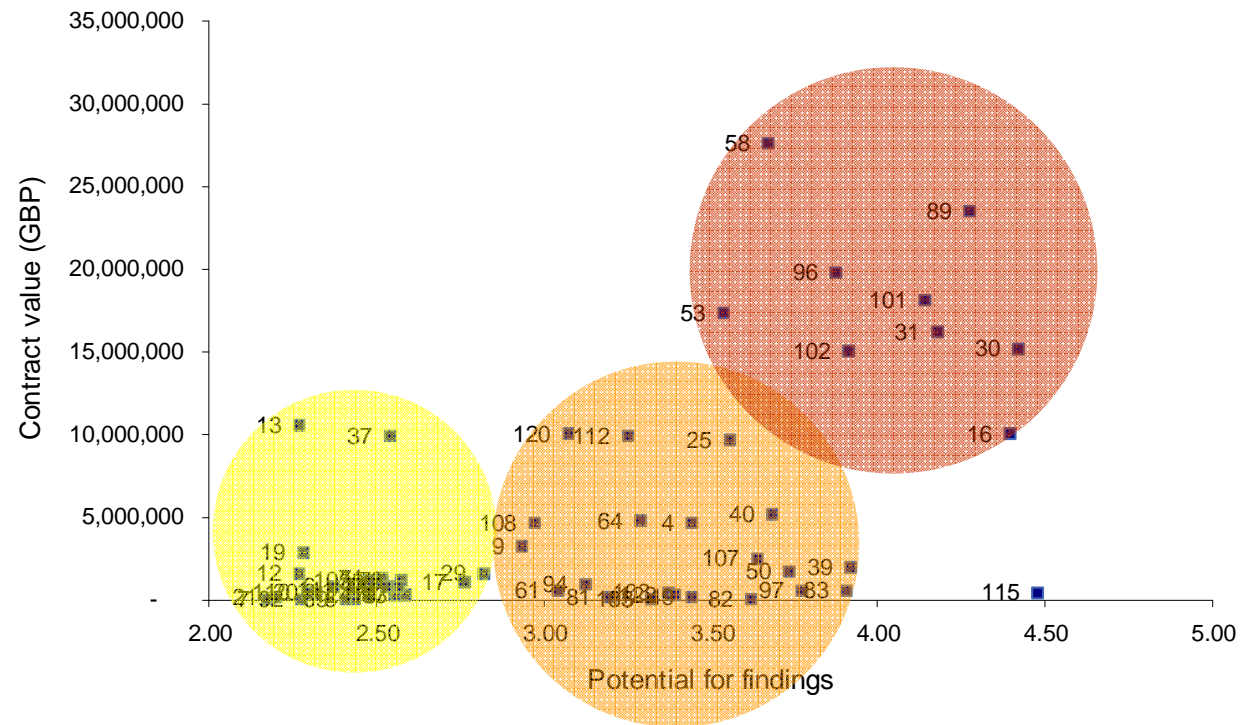
Corruption schemes



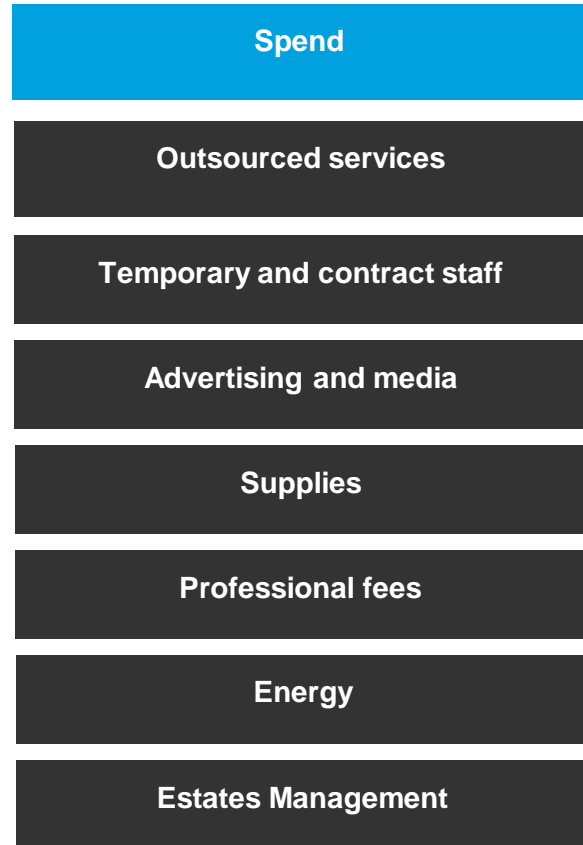
# Which suppliers to review?

Common factors include:

- Spend
- Type of goods/service
- Geography
- Contract terms
- Billing complexity
- Contract manager
- Stakeholder views
- Press coverage
- Management information



# Quality of Contract Management



## Typical financial findings

- Duplicate invoices
- Invoice errors
- Self reported performance errors / performance issues
- Failure to pay rebates
- Rates not in line with contract
- Allowable/disallowable
- Expenses, bonuses
- Mark ups
- Prices not honoured

# Taking a closer look – what can you do?

In today's economic environment, cost control is a key feature of any organisation's strategy. One of the core opportunities to reduce costs is to look at the expenditure and cash outflows that the organisation currently incurs and challenge whether they are being incurred legitimately and appropriately.

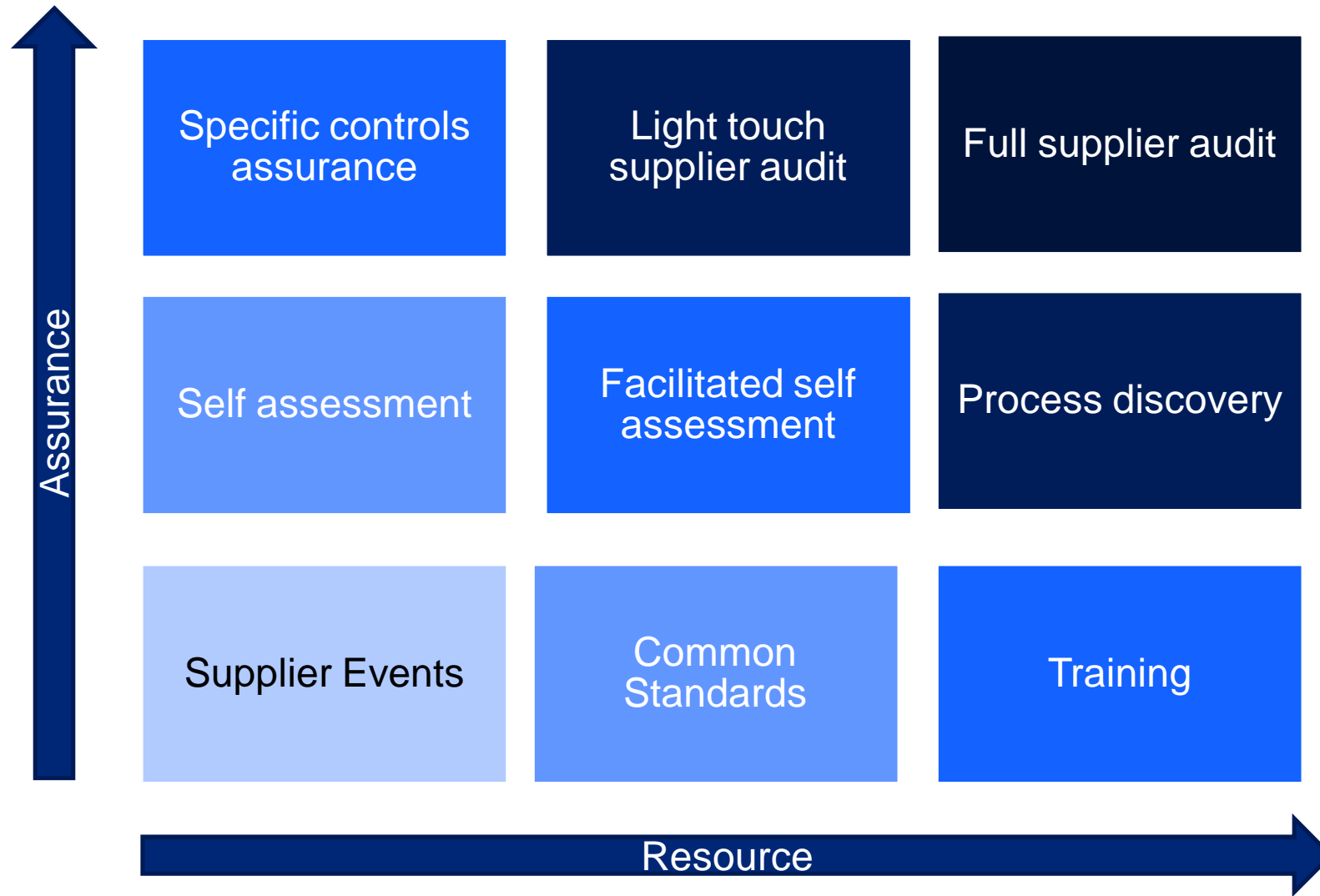
## *Key areas of focus:*

- Maximise underutilised credit terms
  - 3% of purchase ledger documents valued at £39m have “paid dates” in advance of payment due date suggesting missed opportunities for negotiating early payment discount and lost interest.
- Identifying invoice posted twice and separate invoices for the same good or service
- Identifying unused supplier discounts
  - Identified an accumulated value of £2million of unrealised payment term discounts, this led to improved processes and controls to ensure discount opportunities are maximised.

# Taking a closer look – what can you do?

- Look to identify suppliers that are at high risk of non payment
  - Closer attention to aged creditors
- Look for potentially fraudulent activity, such as employee/vendor master matches, related parties etc
- Identify areas to improve efficiency, such as dated practices or high rates of error (staff training needs)
  - Identify benefit of changing the method of supplier payment from manual to BAC's, one local council saved estimated £800k in one year.
- Consider the pressure to spend at year end – control override?

# Alternative forms of assurance



# Wrap up

## Questions to ask

- How many of our key suppliers are in financial distress?
- Where is the fraud in my supply chain?
- Are we being charged in line with contractual agreed rates?
- Is our supplier subcontracting without our knowledge?
- How can I ensure that suppliers are meeting my ethical standards?
- Are we consistently telling our suppliers what we expect of them?



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