

MEETING:	AUDIT AND CORPORATE GOVERNANCE COMMITTEE
DATE:	28 TH SEPTEMBER 2009
TITLE OF REPORT:	AMEY SERVICE DELIVERY PARTNERSHIP COST CONTROL
DIRECTOR OF ENVIRONMENT AND CULTURE	MICHAEL HAINGE

CLASSIFICATION: Open

Wards Affected

County-wide

Purpose

- (i) **To report on the provisions in place for the control of costs in relation to the Service Delivery Partnership with Amey.**

Key Decision

This is not a Key Decision.

Recommendation

THAT Committee:

- (a) **Note the content of this report.**

Key Points Summary

- The recent renegotiations with Amey in respect of the Service Delivery Review have secured revisions to the contractual arrangements to deliver savings, improve performance and drive value for money and cost control.
- The existing contracts remain in place with Amey for a wide range of contract and consultancy services and have a range of mechanism through which the Council can manage cost. These focus on aligning cash flow with the delivery of an agreed programme.
- For contract services the delivery through a joint venture enables further opportunity for financial

Further information on the subject of this report is available from
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management and the sharing of gain made through efficient and effective service delivery. For consultancy services gain is shared through a target cost payment mechanism.

- The total cost of delivery of the Services to Herefordshire is the sum of payments to the consultant, contractor and the Council's 'client' costs less the Council's share in the contractor's profit (through the Joint Venture).
- The Service Delivery Review has secured a series of enhancements that will enable further control on cost as a result of the change to a Managing Agent Contract (MAC) for the delivery of a range of services which includes Highways, Parks and Public Open Spaces, Public Rights of Way, and Ancillary Services.
- These enhancements include an improved payment process, the risk based selection of payment mechanisms (the means by which the price for works and services is derived, as opposed to the process of paying for the works and services), improved financial reporting against budgets, a report detailing actual direct costs of delivery through the supply chain and an annual value for money review that will inform service and business planning and seek to manage the effects of inflation locally (comparing it with a nationally recognised baseline).
- A revised client team under the management of the Council's Highway Network Manager has been formed and is being developed to manage the relationship between Amey and the Council. They are tasked with ensuring that the Council gets value for money from its spend, through ensuring that payments are being made in accordance with contractual requirements, and that through appropriate challenge continuous improvement in value for money is being realised. All Council officers have their own obligations in regard to financial management and cost control. The client team will be working with both the wider Council Client and Amey, to ensure the planning and development of strategic policy in regard to finance, to enable both the continuity and continuous improvement of services.

Alternative Options

- 1 None.

Reasons for Recommendations

- 2 This report provides a response to the question raised by the Committee on the 19th June 2009.

Introduction and Background

- 3 At their meeting of the 19th June 2009 the Audit and Corporate Governance Committee resolved that a report be submitted to the Committee on the provisions currently in place for the control of costs for the future Amey contract. This report has been prepared in response to this resolution.

Key Considerations

Existing Contracts with Amey

- 1 Existing contracts with Amey form what is known as a Strategic Service Delivery Partnership. Herefordshire's Strategic Service Delivery Partnership consists of a three-way partnership between the 'Client', Herefordshire Council, the 'Technical Consultant' Amey Consulting

(formerly Owen Williams Ltd.), and the 'Contractor' Amey Wye Valley Ltd (formerly Herefordshire Jarvis Services). Herefordshire Council has contractual links with both Amey Consulting and Amey Wye Valley, through 10-year contracts which commenced on the 1st September 2003. These contracts are extendable for up to a further 10 years and they are based on a contract form called the New Engineering Contract (NEC).

- 2 In addition to this Amey Wye Valley is a Joint Venture between HC and Amey, serving as a vehicle for the delivery of contract services to Herefordshire and others. This Joint Venture model essentially consists of the following components:
 - The Council and the Contractor are shareholders in the JV Company.
 - The Contractor paid a one off introductory fee to the Council in return for the business opportunity.
 - The Contractor would receive a fixed annual management fee from the JV Company in return for his project management skills.
 - Any profit in excess of this would be split between the shareholders.
 - The JV Company would have agreed targets for its growth.
 - The Contractor would underwrite the JV's operational performance, through a Parent Company Guarantee.
 - The JV Companies Board would be made up of Directors from the Contractor and Observers from the Council.
 - The JV Board would require the prior consent of the Council to operate outside certain well-defined political and commercial boundaries.
- 3 The services delivered by Amey to Herefordshire encompass highways, facilities management, fleet management and a range of ancillary services.
- 4 A Priced Contract with Activity Schedules (Option A of the NEC Engineering and Construction Contract (ECC)) is used for contract services. Each service area is divided into Activity Schedules (AS) for reactive works, routine works, programmed works, specialist works, and weather and other emergencies.
- 5 For reactive and routine works a series of monthly items and rates are established in the AS and this is the price to be paid for those functions.
- 6 For programmed and specialist works a Schedule of Rates (SOR) sits behind the AS and this SOR is used to formulate the price of each activity to be undertaken.
- 7 Weather and other emergencies are treated as a 'hybrid' with 'routine rates' being entered in the AS to cover the provision of an emergency capability, and 'operational rates' being entered into a SOR to formulate the cost of the 'on the ground' response.
- 8 For technical consultancy services a Target Contract (Option C of the NEC Professional Services Contract (PSC)) is used, with a schedule of hourly rates established to calculate the price to the Council.

How the payment mechanism in the existing contract services contract can be used to control costs and the support the delivery of desired outcomes.

- 9 An AS is a list of activities that are to take place in order to complete the whole of the works. Under the NEC Conditions of Contract Option A, when the Contractor has priced the activity schedule, the lump sum for each activity is the price paid by the Employer for that activity once completed. The total of these prices is the Contractors price for providing the whole of the works including for all matters, which are the Contractor's risk. There is provision in the Contract for adjusting the activity schedule for compensation events, as might result from change.

- 10 In order to generate cash flow it is necessary for the Contractor to breakdown the works into a series of activities. In order to progress all the activities to completion and hence payment, the interdependencies between activities must also be understood. Consequently this contract form promotes and relies upon good project management practices and the use of a programme of works to identify and track the progress of the activities. This as payment is aligned to the delivery of that programme.
- 11 To achieve the outcomes desired, contribution is required from all partners. As such the development and management of the whole programme is the responsibility of the partnership. The programme needs to be constructed and managed by the partnership, in line with the Councils available budget, to best achieve the specified outcomes.
- 12 The price for each activity identified in the programme is that price stated for that activity in the activity schedule.
- 13 The payment is made when each activity or specified group of activities has been completed (This motivates the contractor to deliver to programme in order to sustain cash flow). The sum paid to the contractor is the total of the prices for the completed activities and any additional payment as a result of a compensation event. As the works are described as being services to the value of the Council's available budget, assuming the works are delivered to programme, the annual total payment should equal the budget, and any additional payments will necessitate a corresponding amendment to the programme.
- 14 Compensation events are events, which if they occur, and do not arise from the contractor's fault, entitle the contractor to be compensated for the effect that the event has on the prices and the completion date. In some cases the result may be a reduced payment to the contractor. The compensation events to be considered are all defined in the contract, they include for events such as changes in the works information and physical conditions.
- 15 In this contract sitting alongside the activity schedules is a schedule of rates. The schedule of rates has two purposes. Firstly for programmed works the schedule of rates is used to calculate the price for that activity. Secondly for other types of work (i.e. routine works) the schedule of rates can be used to demonstrate value for money. This can be done by comparing the activity price against the value of the completed work as calculated by the schedule of rates (SOR value). If the SOR value is greater than the activity price then better value for money has been achieved. The rates contained in the schedule of rates were those available to the Council at the 1st September 2003. If an item of work is required that is not listed in the schedule of rates, then the contractor is to provide a quotation for that item and the rate should be negotiated prior to commencing the work.
- 16 Value for money is also gained by a year on year % saving being applied to the activity schedule and the schedule of rates and all rates are inflated over time using indices specified and appropriate to the area of works.
- 17 In practice neither the activity price nor the SOR value is the real cost of the activity as it will comprise of labour, plant and materials (all including overheads). The contractor records these inputs against each activity in order to gauge productivity. As a shareholder in the joint venture company the Council is able to view this information and it is in the interests of the Council that SOR values exceed activity prices and as a shareholder that activity prices exceed the contractor's costs. i.e. that the Council gets value for money at the same time as the Joint Venture Company makes a reasonable profit.

How the payment mechanism in the existing consultancy services contract can be used to control costs and the support the delivery of desired outcomes.

- 18 A target cost payment mechanism is used to incentivise efficiency in the delivery of consultancy services. This payment mechanism works by first agreeing a target cost for the activity (or commission) to be completed. This target cost is established by agreeing the staff grade and hours that, based on the experience of previous similar commissions, will be needed to complete the specified activity. The target cost is then calculated using a schedule of time charge rates. If the scope of the activity changes then the target cost can similarly be varied through the assessment of a compensation event (in the same way as described above).
- 19 Whilst the activity is underway the consultant is paid at the time charge rates plus a management fee for all inputs to the activity, regardless of the agreed target cost.
- 20 Once the activity is completed the sum of the time charges and fees against the activity are compared to the agreed target cost. If the time charges are higher than the target cost, then the consultant pays back a proportion of the difference, in our existing contract this is 50%. As such the price that is actually paid by the Council is the target cost plus 50% of the spend over the agreed target price.
- 21 If the time charges and fees are less than the target cost then the consultant is paid a proportion of the difference in addition to the time charges paid to date, again in our contract this is 50%.
- 22 When time charges and fees exceed the target cost the consultant risks an under-recovery of his staff costs and overheads. When the time charges and fees are less than the target cost the consultant recovers costs at a rate which is greater than planned through the time charges and fee alone.
- 23 When time charges and fees exceed target cost the Council does pay more than was 'targeted' for the activity, but does not pay the full time charge cost of the work done. When the time charges and fees are less than target cost the Council pays less than was planned. This mechanism, whilst more complex to administer, does provide both parties an incentive to work efficiently, as both will either share in the reward, or suffer the financial pain of inefficient delivery against target.

Existing Payment Processes

- 24 The current process for contract services involves the contractor presenting a gross application at the end of every month, containing details of every transaction since the beginning of the contract in 2003. Currently it is the Council's practice to prepare its own monthly valuation of the highways programme using its own systems as a tool to determine the amount due at any particular assessment date. For other areas of work the Council requires client officers to review the application and identify any deductions from the payment requested, for example due to works claimed but not completed to the client officers' satisfaction. Following the review by client officers the Council's project manager compiles a draft payment certificate, which is shared with the contractor for final comment and then passed for payment. Errors, omissions or late comments and returns are catered for in the following month's payment round.
- 25 The current process for consultancy services involves the consultant presenting invoices for each commission at the end of each month, or when work has been completed.

Improvements Secured through Service Delivery Review Negotiations

- 26 Whilst the existing contracts remain in place, the Service Delivery Review negotiations have secured improvements to the contractual arrangements relating to the maintenance and management of services in respect of:
- Highways;
 - Parks and Public Open Spaces;
 - Public Rights of Way, and;
 - The Ancillary Services of printing, catering, courier, recycling, vehicle maintenance and sign shop services.

For all other works and services, such as in relation to Property Services, the provisions of the existing contracts shall remain, unless agreement to do otherwise is subsequently negotiated.

The revised arrangements in relation to these services commenced on 1st September 2009.

- 27 Through these revised arrangements Amey is responsible for the delivery of an 'end to end' service for the above activities. This includes customer liaison, the planning and delivery of works and services, service improvement, performing relevant legislative requirements. The performance regime that has been agreed ties Amey to delivering services in accordance with the Council's established policies and plans and best practice guidance and achieving the Council's desired outcomes for Herefordshire and its communities. This type of arrangement is commonly known as a Managing Agent Contract (MAC).
- 28 The Council shall continue to provide management input as is required to ensure that policies, performance outcomes and agreed financial targets are being achieved. This will take the form of strategic guidance to Amey through the development and approval of policies and plans as are required to meet its relevant duties in law, and achieve the desired outcomes.
- 29 Amey will be responsible for ensuring the effective and efficient delivery of the works and services and will also assist in the development of the Employer's policies and plans as required.
- 30 Through choosing to operate in this way the Council has secured the opportunity to realise annual savings of £1 million whilst delivering service improvement. In return Amey have secured an opportunity to gain contract extensions beyond the original ten year term, if they meet stretching targets.
- 31 A series of enhancements in cost control have been negotiated with Amey, and these are described in the following paragraphs. The Council's client team has a key role in ensuring the effective management of the contract and delivery of the envisaged improvements.

Payment Process for Managing Agent Services

- 32 For works and services delivered through the MAC, Amey will assess the amount due and submit an invoice in an approved format each month. This shall detail the changes in the total price for the works and services delivered that have occurred during the last month. Payment is then made by the Council within three weeks.
- 33 The approved format for the invoice requires Amey to display actual costs, fees and charges, demonstrate approvals for spend / payment and show subcontractor's direct costs where feasible.
- 34 The Council's client team will have the opportunity to review the invoice and have any error corrected. Should an underpayment occur this is corrected in the next invoice. Should an

overpayment occur this is repaid to the Council within 5 working days of Amey having been notified.

- 35 It is intended to extend this same payment process for all works and services delivered to the Council by Amey, this will improve the efficiency and transparency of the payment process and as such benefit all parties.
- 36 The payment process for MAC works and services has been extended to allow the use of a greater variety of payment mechanisms (the means by which the price for works and services is derived, as opposed to the process of paying for the works and services). These now include cost reimbursable ('cost plus fee'), schedule of rates ('admeasurements'), lump sum ('fixed price') and target cost ('gains share'). The choice of payment mechanism is decided 'up front' and will be reviewed periodically. This choice is based on a clear rationale which reflects the apportionment of delivery risk between the parties and the parties' commercial obligations towards each other. This rationale is described further below.

Rationale for the Selection of Payment Mechanisms

- 37 Lump sum is used where there is a 'day-in day-out' requirement to deliver, or a 'seasonal' activity which must happen each year. The risks surrounding delivery will be well known, and the real challenge is to enhance efficiency and effectiveness each day/season. Examples of these activities include the cyclical repair of potholes in the highway, and the preparedness for winter gritting.
- 38 Cost reimbursable is used for 'once in a while' activities where it is known that 'it' might happen, but the timing and scale are difficult to predict, the challenge is to react at relatively short notice and provide a response that matches the scale of the event. An example of these activities is the emergency response to flooding.
- 39 Target cost is used for activities where the apportionment of risk between the parties is not distinct, or where through collaboration on a repeatable task improvement in the cost of delivery might be driven out and shared between the parties. In such cases target cost may be the most appropriate mechanism, as it should incentivise collaboration and effective partnership. We have revised the gain/pain share arrangements to increase the Council's share of the gain to 70% if the 'share range' being considered in this mechanism is 20% or more below the target cost. Amey will also take 100% of the pain if the 'share range' is 20% or more over target. This will encourage the setting of realistic target costs and enhance the focus on delivery to target. An example of where this approach could be applied is highway resurfacing.
- 40 Schedule of rates is used where the risk in regard to the cost of delivery is best taken on by Amey, but the risk in regard to volume sits with the Council. Examples of these activities are the delivery of highway improvement works, and winter gritting runs.

Future Financial Reporting Requirements

- 41 Each months Invoice will be accompanied by an Actual Cost Report and a Financial Report in approved formats.
- 42 The Actual Cost Report will detail by individual activity Amey's direct costs of delivery. These broken down, as appropriate into the headings of People, Equipment, Plant and Materials, Charges, Manufacture and Fabrication, Design and Insurance. The costs which should be included for in each heading are defined by the contract in a 'schedule of cost components'.
- 43 The Actual Cost Report also requires Amey to detail by individual sub-contract activity sub-

contractor prices and whenever reasonably available the sub-contractors direct costs of delivery in the same way as if the works were delivered by Amey as the main provider.

- 44 This report will also be presented in a summary form collating all costs (Amey's own and those of their sub-contractors) by activity and comparing them with the price to be paid by the Council for each activity.
- 45 Finally this report will include a summary of all costs by area of service, comparing these with the price to be paid for these services.
- 46 The monthly Financial Report will detail all budgets and provide forecasts for each budget line.

Value for Money Review as part of the Annual Service Plan

- 47 An Annual Service Plan will combine both the Council's service planning information and the Amey's business planning into one plan. The Plan will incorporate both budget and performance information and the anticipated margin.
- 48 The approach to updating the price of Works and Services underlying the service plan will take the form of a value for money review that will take account of the results of the agreed continual improvement process, the performance of target cost projects, benchmarking analysis and the analysis of the actual cost reports.
- 49 This review will be conducted by the Council's Highway Network Manager and the findings will be reported to the Strategic Partnership Board. The report will be produced in time for the accepted recommendations to inform service planning and budget setting.
- 50 The Value for Money Report will be based on:
 - The Actual Cost Report, which is intended to give an understanding of the Amey's cost drivers.
 - A review of rates provided by Amey's Commercial Team and analysis by Client Team.
 - Previous years' results when available.
 - The results of continuous improvement initiatives.
 - Improvements identified using the Target Cost payment mechanism.
 - External checks and benchmarks on quality of service and cost to the Council on the one hand and rewards for Amey on the other.
 - Staff costs inherited by the Amey from the Council and any other local factors such as the cost of providing the level of business continuity required by the Council will be considered.
 - Any other relevant information identified by the Highways Network Manager.
- 51 The report will identify areas for action to be agreed by both parties to ensure the development of the contract and partnership arrangements. These actions will seek to:
 - Ensure that prices are aligned with the cost of service delivery across all services within the scope.
 - Identify and adjust anomalous rates
 - Provide a set of rates that support the delivery of the service plan
 - Ensure that both local inflation and efficiencies are reflected in the price.

- 52 The rates and prices in the contract are inflated each year using a set of agreed indices which reflect the effect of inflation nationally within each area of works or service. However the annual value for money review will provide an opportunity to adjust rates and prices to reflect the impact of inflation locally, together with efficiencies achieved and ensure continued value for money.

Effective Strategic Client Team

- 53 A client team headed by the Highway Network Manager has been established to manage the relationship with Amey on behalf of the Council, this with the aim of ensuring that desired performance outcomes and financial targets are being achieved, and to develop a culture of continuous improvement through productive partnership that will deliver value for money.
- 54 The team includes, in addition to the Highway Network Manager, posts to manage performance, delivery and to scrutinise costs.
- 55 Specialist Cost Control Engineer roles will be central to the issue of cost control. They will be tasked with ensuring that Council gets value for money from its spend, through ensuring that payments are being made in accordance with contractual requirements, and that through appropriate challenge value for money is being realised.
- 56 Clearly this team are not the sole client for the services delivered for the Council by Amey. Whilst they will be managing the contractual partnership arrangements with Amey any Council officer ordering services from Amey must meet their own obligations in regard to financial management and cost control. The Client team will provide advice and support to both the wider Council Client officers and Amey to ensure the benefits of the new arrangements are realised.

Community Impact

- 4 None as a result of this report, though clearly effective cost control will enhance the value for money of those services delivered by the Council through Amey.

Financial Implications

- 5 None as a result of this report

Legal Implications

- 6 None as a result of this report.

Risk Management

- 7 None as a result of this report

Consultees

- 8 None

Appendices

- 9 None

Background Papers

10 None