

# **Leeds City Council**

## **Review of Third Party Client Arrangements**

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# 1 Executive Summary

## 1.1 Introduction

Public Private Partnerships (PPPs) are a key element of Government's strategy for delivering high quality, modern public services. The Private Finance Initiative (PFI) is one type of PPP that has offered Leeds City Council an opportunity to improve its infrastructure and service delivery in an environment of scarce financial resources. However, the PPP procurement process is complex and requires specific skills and expertise to secure deals that represent value for money and that will deliver cost effective services. We have reviewed the Authority's processes to deliver PPP projects with an emphasis on identifying and promoting good practice for future PFI schemes. In particular, we have considered the management of the delivery of the initiatives after reviewing the procurement processes for a sample of large schemes initiated at Leeds City Council. Further details of the schemes considered can be seen in Table 1 in Section 2.2.

## 1.2 Key findings

Overall, we concluded that the Authority's PPP procurement arrangements are satisfactory and include many aspects of good practice such as:

- the recognition for the need to establish a project board for all PPP schemes;
- the establishment of a PPP/PFI co-ordination board providing strategic management and policy direction;
- the implementation of independent reviews at key points in the procurement stage of the project; and
- the recognition of the importance of organisational learning from observations.

There is also a need for further development in a number of areas including development of a contract management strategy particularly once service delivery commences, forward planning with specific consideration to staffing capacity and greater consideration of training requirements across project teams. We recognise that arrangements are developing and there is a need to assess their impact going forward. Our key findings are as follows:

- The Authority is developing a corporate approach for PPP schemes. A recent report to the Executive Board outlined governance and performance management arrangements for all stages of current and anticipated PPP/PFI schemes. These arrangements appear adequate but it is too early to assess whether they have been embedded within the organisation and are operating effectively.
- PFI project teams have evolved largely independently within the Facilities Development Unit (FDU) and the Neighbourhoods and Housing Service Directorate since PFI introduction to the Authority. The emergence of two PFI project teams was largely a reaction to capacity constraints and was not a strategic decision. The Authority should formally consider reviewing these functions to maximise organisational learning, effectiveness and efficiency in the procurement of PFI schemes.
- A framework to formalise organisational learning has been established. Key issues are identified and relayed from project boards on individual schemes at an operational level to the PPP/PFI board at a strategic level. Communication between project teams is essential if the organisation is to learn from its experiences and improve the effectiveness of these schemes. Post evaluation reviews provide an opportunity to identify areas for improvement for subsequent PPP/PFI projects. However, because the procurement process can be lengthy, reviews should be considered at key interim stages of the process.
- Leeds' involvement in PFI projects is growing and good practice suggests that authorities should develop a staffing and training plan during the procurement stage to ensure that they have staff with the right skills and experience to procure the project and then manage the contract. The importance of good contract management needs to be recognised early on in the procurement process if the Authority is to maximise the benefit they receive from a contract.

- The Authority recognises that there are staffing capacity issues and as the Authority becomes more experienced in PPP/PFI planning has improved. This was particularly prevalent within the FDU unit in the procurement phase and an annual work plan is developed to avoid unmanageable workloads. This in part has led to more timely procurement phases particularly on education PFI schemes and should be replicated within other project teams.
- Capacity assessments have not taken place to identify the time required to manage all contracts on service commencement. A robust management and reporting framework should be determined whilst still in the procurement phase and should be in place before service commencement. Express consideration needs to be given to the capability and capacity of officers managing the contract. In particular, the Authority needs to ensure that officers have the skills to generate and present an annual performance report to the PPP/PFI board as required under the current governance arrangements.
- The financing markets are now more familiar with PFI and they are prepared to offer refinancing deals to the early PFI projects. The Cardinal Heenan School PFI project has benefited with the contractor from being re-financed but this was wholly driven by the contractor and not the Authority. Leeds City Council has ensured that future PFI contracts include a contractual clause on refinancing which enables the Council to share in any financial gain derived from the change in risk profile of the scheme once the asset has been constructed.
- The Procurement Unit has recognised that projects such as the impending Design Alliance Partnership and Mouchel Parkman contract which is currently operational demand a greater degree of flexibility to achieve the primary objective of delivering a well integrated, strategic partnership. Currently procurement at Leeds is highly regulated creating a risk that this objective fails to be achieved. Key areas where flexibility needs to be ensured include the term of the contract, the volume of work which is passed to the partner and the scope for involving a consortium rather than a single partner where this better meets local needs.

### 1.3 Key Learning points for future projects

It is important that Leeds City Council learns lessons for future projects from PPP/PFI schemes currently in the procurement phase or operational and that these are communicated within the Authority. The key learning points include:

- The Authority should formally consider and test the degree to which new governance arrangements are embedded within the organisation.
- The Authority should continue to take a corporate approach to the development of PPP/PFI projects to ensure that a planned, balanced and fair view is taken to the allocation of resources to achieve corporate goals. The Authority should consider undertaking a review of its current arrangements and structures within directorates involved in such schemes to report on the performance of PFI and other third party contracts which have entered the service delivery stage.
- Independent reviews at key interim stages of the procurement process should be mandatory to identify lessons to be learnt for future schemes.
- The Authority needs to enhance quality assurance processes, including ensuring quality and timely performance management information is communicated to the PPP/PFI Board.
- Contract management strategies should continue to be developed for future projects setting out the boundaries and framework for managing the relationship with the contractor.
- Development of a staff training plan in all project teams during the procurement stage to ensure that the Authority has the right skills and experience to manage the contract.
- There is a need to create a service management framework for the ongoing monitoring of value for money and affordability.

- The Authority should implement a review of capacity within the project teams to deliver current and anticipated PPP/PFI schemes and investigate whether the integration of the teams would improve the communication of good practice, sharing of knowledge and aid in developing staff training.
- The Authority needs to ensure that officers are being utilised as effectively as possible on a corporate level to achieve the organisation's goals. There is also a need to ensure that key team members are retained in the face of competition from private sector demand for project management skills.
- A review of the corporate procurement process is currently being undertaken within the procurement unit at the Authority but equally current standard contract terms and conditions should be reviewed to ensure that they allow the Authority to attract committed quality partners and are flexible enough to allow strategic partnerships to develop.

#### **1.4 The Way Forward**

We will discuss the findings of this review with officers to agree an action plan to address the key issues. In addition, we shall continue to work with officers to constructively challenge the management arrangements for future PPP/PFI schemes undertaken by the Authority.



## 2 Introduction

### 2.1 Introduction

This review of third party client arrangements has been undertaken as part of the Audit and Inspection Plan 2004/05 in our capacity as external auditors to Leeds City Council.

### 2.2 Background

Leeds City Council has significant experience of letting and managing a range of contracts as it seeks to deliver high quality, modern public services through Public Private Partnerships (PPPs). These include a number of Private Finance Initiative (PFI) schemes, such as Leeds Primary Schools project and Swarcliffe Social Housing programme.

The Authority is considering a number of new schemes including a Waste Procurement exercise. In preparation for this it requires a review of its client side arrangements for its long term third party contracts to include both corporate arrangements and those in service directorates.

A recent review by the Audit Commission of PFI arrangements identified issues with contact monitoring arrangements for the Seven Schools Project. As this PFI scheme has been reviewed by the Audit Commission we did not complete any specific work on this area. The recommendations from the review will be considered in relation to the overall arrangements and capacity. The projects considered in this review are set out in table 1. These represent a sample of the PPP schemes which Leeds is currently undertaking or intends to procure. We have considered schemes of varying size, stage of completion and differing focus. Other schemes which were not specifically considered but discussed where applicable include PFI schemes such as the Leeds Combined Schools project, Leeds Seven Schools project, the Little London Social Housing project, the Independent Living project and the Street Lighting project. This is not an exhaustive list of PFI schemes but covers all service directorates who are involved in PFI projects.

**Table 1: Leeds CC PPP Projects**

<b>Description of Project</b>	<b>Swarcliffe Social Housing</b> – provision of good quality housing for tenants of approximately 1,600 Council dwellings	<b>Leeds Primary Schools</b> – rationalisation of 14 existing Primary Schools to 10 schools with early years provision	<b>Mouchel Parkman</b> – third party contract to provide engineering services to Leeds City Council	<b>Design Alliance</b> – third party contract to provide architectural services to Leeds City Council
<b>Capital Value</b>	£113m	£36m	N/a	N/a
<b>PFI Credit</b>	£78.8m	£32m	N/a	N/a
<b>Operational period</b>	March 2005 to 2035	March 2004 – 2029	September 2003 – 2006	Project at tendering stage

### 2.3 Scope and objectives

The objective of our review was to consider the arrangements to deliver partnership projects and identify from this any improvement opportunities. We considered the strategic and control issues to ensure the proper control of third party contracts. In particular our review specifically considered:

- Overall management arrangements for the process, including management structures, levels of experience and skills, arrangements for keeping knowledge up to date and leadership (sections 3, 4.3 and 4.4).
- A high level review of current capacity and structures within the Authority’s client arrangements for major third party contracts (section 4.2).
- A light touch review of the Authority’s procurement processes, including contract review arrangements, the requirement for continuous improvement, the management of risk allocation and reduction and arrangements to demonstrate that the deals meet best value requirements (section 6).

- Having agreed the major third party contracts to be included within the review this initial stage considered the adequacy of the current management arrangements for safeguarding the Authority in respect of its:
  - initial deal structure negotiation and agreement; (section 5.2)
  - contract variation (section 5.3); and
  - ongoing monitoring and management after contract commencement (section 5.4).
- Identification and consideration of potential future arrangements (section 1.3).

Whilst we have reviewed specific schemes the emphasis was on identifying opportunities to learn and promote good practice for future contracts. For example, we considered the extent to which there has been skills transfer between departments and between those negotiating and subsequently running contracts within a department.

## **2.4 Audit approach**

Our approach has been to:

- interview key officers involved at the various stages of procuring and managing PFI and third party contracts;
- review the key processes in the PFI procurement lifecycle;
- review relevant documentation; and
- compare good practice and communicate this across the Authority.

## 2.5 Acknowledgements

We would like to take this opportunity to thank all the officers who supported this study.

## **3 Overall Management Arrangements**

### **3.1 Introduction**

This section reviews the overall arrangements for managing the PPP/PFI schemes selected. Experience from early PPP/PFI projects can offer opportunities to improve management arrangements for both current and future PPP/PFI schemes. Good practice suggests that long term capital decisions including PFI schemes should not be taken in isolation, they should be considered in conjunction with other capital decisions and the Authority's strategic vision. Following recent reviews by the 4P's Leeds has introduced a corporate framework for the monitoring and reporting of PFI projects. This is detailed in appendix 2. The structure demonstrates high level input underlining the significance of schemes to achieving the corporate plan and the publicity it could attract if projects were to fail.

### **3.2 Overall management arrangements**

In this report we have primarily focused on the high-level arrangements for management of the PPP/PFI contracts but have also drawn upon issues raised in reports commissioned which focused on the operational and business level management where appropriate.

### **3.3 PFI Schemes at the Higher Level**

The high level management structure of PPP/PFI schemes has been formalised following a report to the Executive Board dated 9 March 2005. The structure is now in place. We have documented this in appendix 2 (current PPP/PFI Governance Arrangements) and table 2 (each respective group's role and membership).

### **3.4 Managing Projects**

Although Leeds have developed a corporate approach to the management of PPP/PFI schemes at operational level there is a lack of clarity in roles between the procurement team and the client performance management team once the contract has been signed and service delivery commences. The procurement team management structures for the PPP/PFI schemes at Leeds also vary under the FDU, Neighbourhoods and Housing PFI schemes and other third party contracts. (See table 3).

Table 2 – PPP/PFI Group Membership and Functions

Group	Role	Membership
PPP/PFI Projects Co-ordination Board	To provide overall direction for the strategic management of PPP/PFI cross cutting issues corporately such as insurance, risk management, affordability issues, lessons learnt and to set cross cutting standards reporting to the Executive Board.	Director of Legal and Democratic Services Director of Development Director of Corporate Services In attendance as appropriate: Project Sponsors Chief Executive Education Leeds ALMO Chief Executives Other Service Directors Head of Facilities Development Project managers and technical specialists as required e.g. legal and financial advisors
Project Board	To provide overall direction and management of the project at an operational level with authority to make delegated decisions. To report to the Executive Board and to the PPP/PFI Projects Co-ordination Board where a cross cutting issue arises.	Membership includes using the Primary Schools Project as an example: Project Sponsor Representative Legal and Democratic Services Representative Development Department Representative Corporate Services Representative Education Leeds Education Project Director External advisors as required
Project team	A temporary organisation created to deliver the project of behalf of the Authority reporting progress to the Project Board.	Members includes: Project Officers (Facilities Development Unit (FDU)/Service Department) Technical specialists (FDU/Service Department) Project administrative support External advisors as required

The project teams detailed on this page evolved separately within the FDU unit and the Neighbourhoods and Housing directorate. This is a function of a number of factors such as the nature of the schemes that the teams have been involved in, the level of activity and the degree of external advice sought. The Neighbourhoods and Housing PFI team developed within the Regeneration Service which is part of the wider Regeneration Projects and Programmes Division within the Department. This procures and delivers on a range of PPP projects. The present teams can be seen in the table below:

**Table 3 – Project team structures**

<b>Project team FDU Unit</b>	<b>Project Team Neighbourhoods and Housing</b>
Head of FDU 2 Executive Managers <b>(1 post vacant)</b> 5 Executive Project Managers <b>(1 post vacant)</b> Executive Technical Manager Executive Manager Performance and Risk Executive Manager Finance Executive Manager Legal 8 Managers' roles supporting the Executive Managers <b>(4 vacant posts)</b> 3 Administrators 3 Project Officers Construction Monitor	Regeneration Project Leader <b>(40% FTE)</b> Regeneration Project Manager Regeneration Project Co-ordinator Regeneration Technical Manager Regeneration Service Standards Manager Regeneration Project Assistant Administrative Assistant

Other identified governance arrangements of the schemes include:

- a Project Executive Plan, which includes a programme of events from the OJEC stage to construction stage outlining approval roles and reporting roles for the various parties involved;
- regular reporting to the Authority's Executive Board; and
- obtaining advice and guidance through a third party review of developing and procuring the PFI project (4Ps).

### **3.5 Mouchel Parkman Partnership Management Arrangements**

Governance arrangements currently in place are two-fold. The higher level Partnership Board meets every six weeks and is co-chaired by senior representatives from the Authority and Mouchel Parkman. At an operational level, a Steering Group was established which meets informally approximately three times weekly.

The high-level Partnership Board has representatives from the service departments who use Engineering Services such as Street Scene and Development Department, as well as a representative from the Best Value team. Whilst in the procurement phase, the project team realised that cross party support, Trade Union and Chief Executive's office support was paramount and representation was duly arranged.

The Project team consisted of a technical representative from the Highways Department, a member of the Procurement Unit, legal and financial expertise drawn internally and externally.

### **3.6 Design Alliance Partnership Management Arrangements**

The Governance arrangements for the impending Design Alliance are similar to the Mouchel Parkman contract. A Project Board has been established at a strategic level which will meet quarterly. At an operational level the core team meet weekly. This team includes a representative who was involved in the negotiation of the contract. A critical success factor identified early by the team was getting the Service Directorates involved in the earlier stages to promote ownership of the service following contract signature.



### 3.7 Management and Governance Arrangements at Leeds

Following the report to the Executive Board, the Authority has structured arrangements for managing, monitoring and reporting on PPP/PFI schemes. It is still too early to assess the extent to which this framework enables individuals and groups to understand their aims/roles and allow those outside the group to understand how the project is being managed. Although a corporate framework has been established at a strategic level, at an operational level separate approaches exist within project teams for monitoring the contract once the delivery stage has commenced. This is a reflection of the fact there was no clear strategy at the outset of Leeds involvement with PPP/PFI schemes and management arrangements were implemented without detailed consideration of structure.

#### **Recommendation 1**

The Authority should consider undertaking a review of its current client arrangements and structures to monitor performance of PFI and other third party contracts establishing clarity of roles between procurement and performance management teams.

The strategic governance arrangements for PPP/PFI schemes detailed above have led to a PPP/PFI project board being established. The fact that this board is influenced and reports to the Executive and Asset Management Board ensures that PPP/PFI scheme decisions are not considered in isolation but in conjunction with other capital decisions and the Authority's strategic objectives. These arrangements appear adequate but it is too early to assess whether they have become embedded within the organisation.

#### **Recommendation 2**

The Authority should undertake a review to determine the extent to which the Corporate Governance framework has been embedded within the organisation.

## 4 Capacity and Learning

### 4.1 Introduction

This section considers arrangements to develop skills, secure knowledge transfer regarding PPP/PFI within the Authority and whether there is sufficient capacity to ensure effective project management and subsequent ongoing management of services provided under contracts.

### 4.2 Capacity

Although there are different project teams, comments from officers suggested that capacity was a key common issue at both the procurement phase and post contract commencement. In terms of PFI procurement, the FDU is running at approximately 75% capacity with a number of key posts currently vacant (see table 3). The PFI procurement team within Neighbourhoods and Housing is also running with a shortage of key personnel at the contract monitoring stage. The Design Alliance Partnership procurement team suffered the loss of a lead member through early retirement before adequate knowledge transfer had taken place. Throughout the Development Department recruitment and retention of quality staff is a problem. Staff turnover is particularly problematic due to the commitment required to fully understand a project and see it through the procurement phase.

This problem is compounded by limitations in Leeds City Council pay scales and the fact that due to the popularity of such schemes nationally, skills acquired whilst negotiating and managing such complex PPP/PFI schemes are in high demand by the private sector. Such demand is inflating remuneration levels beyond the Authority's current pay scale for such posts.

#### **Recommendation 3**

The Authority needs to ensure that officers within the authority are being utilised as effectively as possible at a corporate level to achieve the organisation's goals. There is also a need to ensure that key team members are retained in the face of competition from private sector demand for project management skills. A review of the current remuneration policy and distribution of experienced officers is recommended.

Although there are obvious capacity constraints, the procurement teams within the FDU and Neighbourhoods and Housing are highly skilled and experienced officers. However, organisational learning on the whole has been informal and mainly 'on the job'. Only recently formal structures have emerged which enable training needs and skills gaps to be more easily identified.

#### **Recommendation 4**

A medium term strategic work plan should be prepared annually within the FDU and Neighbourhoods and Housing directorate to consider the PFI projects due and any skills shortages which are apparent. Any skills gaps should be identified and filled either through re-deployment internally, recruitment or employment of advisors.

### **4.3 Skills and knowledge transfer**

From discussions with officers, the procedures for review and organisational learning differ between teams and projects.

The FDU unit has started to implement independent Gateway reviews of the procurement process through using third parties (4Ps), for example on the Building Schools for the Future project. Findings from these reviews are then fed to the PPP/PFI Project Co-ordination Board for discussion and highlight skills gaps and training needs.

Neighbourhoods and Housing conducted an in-house review on completion of the procurement phase of the Swarcliffe Social Housing PFI project. This included representatives from the core project team and drew positive and negative points for consideration ahead of a similar housing scheme in Little London.

The in-house review on the Swarcliffe project highlighted team commitment, good working relationships between the component parts of the project team and the fact that the deal was signed. Negative observations included inefficient use of time at the planning and negotiation stage (as detailed in section 4.4), project team resources were far too small (section 4.2), it was difficult to involve the FDU as they had capacity issues at the start of the project (section 4.2), no learning was passed from FDU to the Swarcliffe team, minimal internal legal and technical resources were available, poor stakeholder liaison with tenants and the ALMO and the fact that the Authority lost support for new social housing projects.

At the time of this review, these findings had not been fed back to the PPP/PFI co-ordination board in detail and no action plan with ownership and timescales was developed. This report is currently being prepared and will be presented to the PPP/PFI Board in October 2005.

#### **Recommendation 5**

A detailed post evaluation review should be carried out to ensure that any lessons that can be learnt from the difficulties encountered on projects are taken on board for any future PFI schemes. The review should be independent and action points should be formalised and ownership assigned for implementation.

No upfront consideration of skills within the Authority is undertaken before project initiation with the exception of the FDU which prepares an annual work plan to recognise capability and capacity constraints. Also, there is little consideration between training undertaken by the Neighbourhoods and Housing project teams and the FDU project team and there could be a high degree of overlap.

#### **Recommendation 6**

The Authority should review its approach to training and developing skills for PFI specialists and for major projects and partnerships set up. In particular the Authority should ensure that training requirements within the FDU and Neighbourhoods and Housing PFI teams are considered concurrently.

#### 4.4 Project Leadership

Due to the complexities of PPP/PFI contracts clarity of focus, strong leadership and well defined roles are paramount between the various teams within the Authority. If these are not achieved there is the risk that the Authority will fail to deliver on contracts.

Effective contract management activities can be grouped into three areas:

- **Service delivery management** ensures that the service is being delivered as agreed, to the required level of performance and quality;
- **Relationship management** keeps the relationship between the two parties open and constructive, aiming to resolve or ease tensions and identify problems early;
- **Contract administration** handles the formal governance of the contract and changes to the contract documentation.

Whilst also depending on good preparation and the right contract, all three areas must be managed well. Management structures for contracts need to be designed to facilitate a good relationship, and staff involved at all levels must show commitment to it. Information flows and communication levels should be established at the start of a contract and maintained throughout its life. The three primary levels of communication in a contractual arrangement are **operational** (end users/technical support staff), **business** (contract manager and relationship manager on both sides) and **strategic** (senior management).

Within the FDU there appears to be a clear distinction between the project team leading the procurement phase and the Service Directorate as client for the PFI scheme post commencement. Historically, there have been inefficiencies caused by vagueness in the project definition on the client side. Having clarity of roles has helped the FDU unit deliver projects more effectively and in a shorter term. The Design Alliance project was hampered by the loss of the lead officer mid way through the tendering process. The decision was then made to widen the participation and management of this project so that knowledge was shared and the risk of the project faltering through the loss of a key officer reduced.

Swarcliffe Social Housing review highlighted that this problem occurred in the procurement stage of this PFI scheme. There was a mixing of client and procurement functions which was inefficient and this was further complicated by the introduction of the ALMO mid-way through the tendering process.

#### **Recommendation 7**

The Authority should prepare a contract management strategy setting out the management structures and boundaries for managing the relationship with the PPP/PFI contractor for future contracts. All PPP/PFI schemes should have clear distinctions between the procurement and client functions.

## 5 Contract Management

### 5.1 Introduction

PFI procurement usually ends with the operator/contractor having to undertake a significant amount of capital work usually in the form of constructing facilities and then servicing the asset constructed. Client-side management arrangements should be established in the procurement phase to ensure that the contractor is held to account and monitored against key performance indicators in the contract to ensure effectiveness of service delivery is maximised.

In the case of Leeds City Council, most PFI schemes to date have involved the construction of schools and improvements to housing stock. The Authority needs to ensure effective contract monitoring of the various performance indicators which are outlined in the PFI contract. Sharing of knowledge between officers involved in procurement and contract management is also critical to a project's success when the service element of the contract commences.

### 5.2 Deal Negotiation

Deal negotiation is a critical stage of the PPP/PFI life-cycle. If the Authority is to deliver the service it envisages to the people it serves it must have a clear project definition at the outset. If this is not established the procurement stage is likely to be protracted and costly to the Authority and there is an increased risk that the service delivered is sub-optimal. As highlighted in section 4.4, there is a clear distinction between the FDU and the directorate it serves which is seen as the client. The FDU demands a clear statement of needs from the client and once this has been established with certainty the procurement phase is started. The FDU has learnt from experience that this must be the case and is illustrated by the fact that the time to negotiate and sign contracts on education PFI projects has reduced from project to project.

The Authority identified that clarity of roles in the negotiation stage was not apparent on the Swarcliffe project and this contributed to an extended procurement stage. The increase of PFI credits from £17m to £78.8m was in part due a general lack of clarity at the planning stage but also changes in subsidy and market interest rates inflated the value of this project. Other factors described in section 4.4 that affected project leadership include the project being a 'pathfinder' project meaning no proven model to follow and added complications such as the introduction of the ALMO. Given the term of PFI projects, the capital commitment and contribution to achieving corporate goals the importance of negotiating effectively at the planning stages of a project is paramount.

The contract negotiation with Mouchel Parkman and the proposed Design Alliance is considered in more detail in section 6.

### **5.3 Contract Variation**

Another element of contract monitoring which could be improved is the opportunity for re-financing once the asset has been constructed and therefore a lower risk to the lender. This has occurred on the Cardinal Heenan project and has led to savings to the Authority. However, this was wholly initiated by the contractor. The Authority should have a system whereby the opportunity for re-financing is investigated on each project upon completion of the asset construction phase. The contracts on newer projects have been amended so that any savings as a result of re-financing are shared with the Authority.

#### **Recommendation 8**

The Authority should continue to ensure that future PFI contracts include a provision for sharing any potential gain from refinancing. Any contractual inclusions should conform to the Office for Government Commerce's guidance.



Contract variation helps the Authority ensure that there is continual improvement in service delivery. To date there have been a number of variations to the Leeds Seven Schools and Primary Schools contracts. These have mainly been alterations to buildings' layouts to meet with new Department for Education and Skills (DfES) legislation. An example concerned changes to Nursery and Reception area layout in the Primary Schools project after the contract was signed. This could have been ignored but the Authority was determined to action these changes. Using provisions for change in the contract and renegotiating price meant that the alterations were complete prior to the school being brought in use. Other modifications anticipated include the number of days the schools are required for cleaning and cleaning arrangements. Contract modifications have also been initiated by the contractor increasing the efficiency of service delivery such as the provision of water mains to outlets to secondary schools.

#### **5.4 Contract Monitoring**

The Authority has only reached this stage on the Cardinal Heenan High School and the Leeds Seven Schools projects. The Authority has outlined formal arrangements for reporting progress to the PPP/PFI Projects Co-ordination Board for consideration and impact on future projects.

The Governance structure in place has predominantly been concerned with ensuring that the scheme is properly administered and communicated up until the point where the contract is signed. The Authority now needs to focus on the long-term performance of their PFI contracts and ensure that annual performance reports are presented in a timely manor and of adequate quality to the PPP/PFI Co-ordination Board.

A review of the PFI payment mechanism by Price Waterhouse Coopers in late 2004 initiated by the Scrutiny Board (Learning and Leisure) found the following inadequacies in monitoring arrangements at the Seven Schools Project:

- failure to establish a dedicated contract manager within Education Leeds;
- the helpdesk system established meant that the contractor was failing to log service failures and rectification times;
- the helpdesk inadequacies meant that the contractor was failing to apply deductions and penalties; and
- the contractor had not conducted customer satisfaction surveys therefore failing to ensure continuous improvement of service.

#### **Recommendation 9**

Leeds should ensure it has a clear contract management strategy in place to enable the process to be managed in a more proactive and structured way from the commencement of service delivery. Regular performance feedback to the project co-ordination board for all PPP/PFI contracts should be undertaken.

These issues have led to significantly improved procedures being applied to new PFI schemes. For example, the Leeds Primary Schools project where a programme of liaison between the operational provider Education Leeds and the school has started one year ahead of service commencement.

This however has not been translated to the Neighbourhoods and Housing Department who are currently in the process of recruiting administrative staff for performance measurement on the Swarcliffe scheme. Such measures should already be in place. Also due to capacity constraints within the project teams in the procurement phase, there has been no temporary transfer of the Authority's staff to the project management side after handover.

This is despite the fact that the Authority has built formal performance criteria into the Swarcliffe contract such as Council project meetings which will occur on a monthly basis during the contract term to discuss a statement of progress against predetermined milestones issued by the contractor. Other contractual performance measurement tools include a performance standard benchmarking exercise which assesses performance against the top quartile of English metropolitan authorities in relation to Best Value Performance Indicator 9 and tenant satisfaction surveys.

#### **Recommendation 10**

The Authority should ensure that staff have adequate knowledge of the contract's terms and conditions to ensure that the contractor is delivering as envisaged.

Performance management of the Mouchel Parkman and the Design Alliance contracts will largely be conducted through the Project Boards whose formation are expressly stipulated in the contract terms and conditions. The Mouchel Parkman contract does not contain specific performance indicators which have been incorporated into the Design Alliance contract. The Design Alliance partnership will have a performance manager who is experienced in evaluating the industry standards which are built into the contract. It is intended that customer satisfaction questionnaire results are also collated and reported to the Project Board to ensure continuous improvement and client satisfaction. The FDU unit apply a number of industry standards to their contracts such as ISO9001 which is used as a minimum standard measure of quality for the organisation of the contractors' records. All future projects should have performance indicators and performance managers as part of the contract.

**Recommendation 11**

For all future PPP/PFI schemes the Authority should require the contractor to comply with relevant industry standards.

Performance management in PFI schemes is vital to ensure the scheme is operating as contracted and the correct adjustments are made to the unitary charge. Most PFI schemes allow the contractor to adopt a particular performance management mechanism. The Authority needs to ensure it has the necessary arrangements in place to ensure the performance management information being produced is accurate and the necessary adjustments to the unitary charge are made.

Once this system is in place it is critical that the reporting framework outlined in the recent Governance report is embedded in the organisation and ensuring that the Projects Co-ordination Board receives an annual report from the Service Director detailing contract management arrangements and service management. Other local authorities have utilised their central PFI Procurement Units to advise the relevant departments how to undertake this process either through workshops or secondment of officers.

## 6 Procurement Process

### 6.1 Introduction

This section reports the findings from a 'light touch' review of the Authority's procurement processes, including contract review arrangements, the requirement for continuous improvement, the management of risk allocation and reduction and arrangements to demonstrate that the deals meet best value requirements. Our audit has not included a detailed review of the procurement process for the PPP/PFI schemes under consideration.

### 6.2 Procurement Process at Leeds

The Authority has detailed and highly regulated procedures for the procurement of goods and services. These are governed by internal standing orders and where a statutory value threshold is exceeded, by European Union legislation.

Historically, the procurement process was designed with construction projects in mind. As these projects parameters were largely predetermined there was little scope in the procedure for variation. The process was designed to deliver value for money, transparency, legality and fairness.

The procurement procedure is currently under review as the Procurement Unit has recognised that projects such as the impending Design Alliance partnership and Mouchel Parkman contract which is currently operational demand a greater degree of flexibility to achieve the overriding objective of delivering a well integrated, strategic partnership.

Although value for money is ensured through the tendering process and the use of short-term contracts this detracts from the ability of the Authority to form a strategic partnership with the chosen Company or Consortium of Companies. The two partnerships considered have opted for contract terms of three years plus an additional two years if the Contractor is performing satisfactorily.

Officers in the Procurement Unit commented that the first 12 months of the contract are largely a bedding-in period and only at the end of the second year can meaningful appraisal of the agreement be undertaken. If the outcome of a review at this stage is negative, year three of the agreement will be undermined as the Contractor will have started to engage an exit strategy to some degree.

The Mouchel Parkman contract is nearing the end of the second year of operation. The re-tendering exercise appears to be faced with another difficulty largely due to the success of the partnership.

The bedding-in period described earlier was limited as a large construction scheme came to fruition (the £50m stage 7 of the Inner Ring Road) shortly after the contract was signed. This acted as a catalyst and Mouchel Parkman were forced to commit substantial resource early in the relationship. This was evident by the fact that a Mouchel Parkman satellite office was opened in Leeds. Although the organisations are different in a number of ways, the fit operationally and culturally has worked largely as envisaged. This perversely, creates the problem that after three years the organisations will become so entrenched in one another that a meaningful and fair re-tendering exercise becomes practically impossible.

#### **Recommendation 12**

The Authority should undertake a formal review of the current tendering procedure in the aim to achieve value for money, legality, transparency and fairness yet flexible enough to foster a strategic partnership with a service provider.

In summary, a formal review of the current tendering procedure is required. The aim broadly should be to achieve traditional objectives of value for money, transparency, legality and fairness yet the contract should be flexible and of a term which encourages commitment and development of a strategic partnership. Corporate priorities should be ensured through the inclusion of officers from the relevant service department and draw upon the expertise of the procurement unit.

# Appendix 1

## Recommendations and action plan

***	<i>Significant residual risk</i>	**	<i>Some residual risk</i>	*	<i>Little residual risk</i>
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<b>Recommendation</b>		<b>Priority</b>	<b>Management response</b>	<b>Responsibility and timescale</b>
1	The Authority should consider undertaking a review of its current client arrangements and structures to monitor performance of PFI and other third party contracts establishing clarity of roles between procurement and performance management teams.	***	<p>Leeds City Council is reviewing client departments PPP/PFI structures and is establishing a single template to ensure the roles and skills established within Neighbourhoods and Housing and the PPPU are complimentary</p> <p>Other third party contracts should be monitored to a similar corporate standard with reports to relevant Directors and Internal Audit.</p>	<p>Chair PPP/PFI Projects Coordination Board</p> <p>April 2006</p> <p>Director Development and other Service Directorate as appropriate</p> <p>September 2006</p>



Recommendation	Priority	Management response	Responsibility and timescale
<p>2 The Authority should undertake a review to determine the extent to which the Corporate Governance framework has been embedded within the organisation.</p>	* *	<p>The PPP/PFI Coordination Board will receive a highlight report on the implementation and effectiveness of the corporate governance framework from the Chief Officer PPPU in September 2006 and ensure that the framework is embedded within the organisation.</p> <p>The Executive Board will receive a highlight report on the corporate governance framework from the Chief Officer PPPU by November 2006</p>	<p>Chair PPP/PFI Projects Coordination Board</p> <p>September 2006</p> <p>Chair PPP/PFI Projects Coordination Board</p> <p>November 2006</p>
<p>3 The Authority needs to ensure that officers within the authority are being utilised as effectively as possible at a corporate level to achieve the organisation's goals. There is also a need to ensure that key team members are retained in the face of competition from private sector demand for project management skills. A review of the current remuneration policy and distribution of experienced officers is recommended.</p>	* * *	<p>The PPP/PFI Coordination Board will review the resources to deliver the PPP/PFI portfolio for 2006/07 and ensure they are effectively deployed and utilised for procurement and client delivery by receiving a PPPU resource report from the Chief Officer PPPU by January 2006</p>	<p>Chair PPP/PFI Projects Coordination Board</p> <p>January 2006</p>

Recommendation	Priority	Management response	Responsibility and timescale
4   A medium term strategic work plan should be prepared annually within the FDU and Neighbourhoods and Housing directorate to consider the PFI projects due and any skills shortages which are apparent. Any skills gaps should be identified and filled either through re-deployment internally, recruitment or employment of advisors.	* * *	Refer to recommendation 1	Refer to recommendation 1
5   A detailed post evaluation review should be carried out to ensure that any lessons that can be learnt from the difficulties encountered on projects are taken on board for any future PFI schemes. The review should be independent and action points should be formalised and ownership assigned for implementation.	* *	<p>The PPP/PFI Coordination Board will review evaluation /lessons learnt documents quarterly and ensure actions are implemented</p> <p>A stage evaluation methodology will be developed in consultation with service departments, approved by the PPP/PFI Coordination Board and implemented for the PPP/PFI portfolio by September 2006</p>	<p>Chair PPP/PFI Projects Coordination Board</p> <p>September 2006</p>

Recommendation	Priority	Management response	Responsibility and timescale
<p>6 The Authority should review its approach to training and developing skills for PFI specialists and for major projects and partnerships set up. In particular the Authority should ensure that training requirements within the FDU and Neighbourhoods and Housing PFI teams are considered concurrently.</p>	* *	<p>A training programme will be developed for the PPP/PFI portfolio by April 2006 in consultation with the service departments. Implementation by September 2006, will be the responsibility of the Project Director and budget holder for each service department.</p> <p>Implementation by September 2006, will be the responsibility of the Project Director and budget holder for each service department.</p>	<p>Chief Officer PPPU</p> <p>April 2006</p> <p>September 2006</p>
<p>7 The Authority should prepare a contract management strategy setting out the management structures and boundaries for managing the relationship with the PPP/PFI contractor for future contracts. All PPP/PFI schemes should have clear distinctions between the procurement and client functions.</p>	* *	<p>Develop a contract management strategy by September 2006</p>	<p>Chair PPP/PFI Projects Coordination Board</p> <p>September 2006</p>

Recommendation	Priority	Management response	Responsibility and timescale
8 The Authority should continue to ensure that future PFI contracts include a provision for sharing any potential gain from refinancing. Any contractual inclusions should conform to the Office for Government Commerce's guidance.	✱	The PPPU will develop and implement an annual review system to ensure that all future contracts conform to the OGCs Guidance	Chief Officer PPPU  April 2006
9 Leeds should ensure it has a clear contract management strategy in place to enable to process to be managed in a more proactive and structured way from the commencement of service delivery. Regular performance feedback to the project co-ordination board for all PPP/PFI contracts should be undertake	✱ ✱	Refer to recommendation 7	Chair PPP/PFI Projects Coordination Board  September 2006
10 The Authority should ensure that staff have adequate knowledge of the contract's terms and conditions to ensure that the contractor is delivering as envisaged.	✱ ✱	Undertake a review of the portfolio for PPP/PFI to ensure sufficient resources are assigned to contract management within the PPPU and the service departments for the duration of the programme/project.	Chair PPP/PFI Projects Coordination Board  April 2006
11 For all future PPP/PFI schemes the Authority should require the contractor to comply with relevant industry standards.	✱	Refer to recommendation 9 and 10	Chair PPP/PFI Projects Coordination Board April 2006

Recommendation	Priority	Management response	Responsibility and timescale
12 The Authority should undertake a formal review of the current tendering procedure in the aim to achieve value for money, legality, transparency and fairness yet flexible enough to foster a strategic partnership with a service provider.	* *	Review the current strategic partnership procurement procedure by March 2006	Director Development March 2006

## **Appendix 2**

### **PPP/PFI Governance Structure**

## Appendix Two - PPP/PFI Governance

