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Northern Ireland Audit Office

The PFI Contract for the Education and Library Boards' New Computerised Accounting System

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL

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J M Dowdall
Comptroller and Auditor General

Northern Ireland Audit Office
18 March 2003

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List of Abbreviations

AAP	-	Accruals Accounting Project
BAFO	-	Best And Final Offer
BENT	-	Bid Evaluation and Negotiation Team
BISDC	-	Boards' Information Systems Development Committee
CAPB	-	Common Accounting Project Board
CCN	-	Change Control Note
CCTA	-	Central Computer and Telecommunications Agency
DE	-	Department of Education
DENI	-	Department of Education for Northern Ireland
DFP	-	Department of Finance and Personnel
EC	-	European Community
ISSEC	-	Information System Strategy Executive Committee
IT	-	Information Technology
ITN	-	Invitation To Negotiate
NIAO	-	Northern Ireland Audit Office
NAO	-	National Audit Office
NPV	-	Net Present Value
OGC	-	Office of Government Commerce
OJEC	-	Official Journal of the European Community
PFI	-	Private Finance Initiative
PID	-	Project Initiation Document
PPPs	-	Public Private Partnerships
PSC	-	Public Sector Comparator
SEELB	-	South Eastern Education and Library Board

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THE PFI CONTRACT FOR THE EDUCATION AND LIBRARY BOARDS' NEW COMPUTERISED ACCOUNTING SYSTEM

EXECUTIVE SUMMARY

Background

1. In February 1994 the Department of Education (the Department) set up an Information Systems Strategy Executive Committee (ISSEC) to consider the future use of information technology across the education services. Among a range of projects, the Strategy concluded that there was a need to introduce new financial management information systems into the five Education and Library Boards (the Boards)[1] to enable them to produce commercial style accruals accounts for the financial year 1999-2000 in line with other government bodies. The cost of implementing what became known as the "Accruals Accounting Project" (AAP), over ten years, was projected to be £20. 2 million at 1998-99 prices.

2. When the AAP was initiated in the Boards it broke new ground as a major Private Finance Initiative (PFI) project in the Information Technology sector, involving five of the largest Non-Departmental Public Bodies in Northern Ireland. It is apparent from our examination that a range of complex issues had to be addressed and the Project Board and Project Team successfully handled the procurement and implementation of the AAP. Most importantly, the Project Board succeeded in resolving a number of problems that arose after the implementation of the new system and now has a system capable of producing annual accruals accounts and management information. In this regard, we acknowledge the findings of an independent report dated October 2002.[2] This evaluation of the benefits delivered by the AAP points out that it

1 The Department of Education carries central responsibility for education and related services. However, five autonomous education and library boards are statutorily charged with the executive delivery of education, library and youth services in their respective areas.

2 Accruals Accounting Project, Peer (Gateway 5) Review: Evaluation of In-Service Benefits, October 2002.

was a very major achievement that the project met its primary objectives and congratulated the Project Board and Project Team for dealing successfully with the project's implementation.

3. Nevertheless, the Project Board has not secured delivery of the full system contracted for in that the contractor failed to provide a new payroll and human resources system which formed part of the original specification. Moreover, the main objective of the project was only achieved with significant input by consultants and its attendant costs. At the same time, we recognise that the PFI deal transferred substantial financial risk of late and non-delivery to the contractor, resulting in compensation being paid, thus avoiding costs which would have fallen on the Boards in a conventional programme which ran late and failed to deliver against the full contract specifications.

4. This Report highlights a number of key issues emerging from our review of the introduction of the AAP within the Boards and the lessons which other public sector organisations need to keep in mind when developing and managing relationships with private sector PFI contractors. These are set out below.

Conclusions and Recommendations

On The Procurement Process (Part 2 of the Report)

5. The availability of key personnel is a specific risk in a PFI project. Treasury Taskforce guidance emphasises that it is wise to plan for a strong team from the start, with relevant experience drawn from both inside and outside the client's organisation. The experience of the AAP shows that an issue such as the timely appointment of a Project Team could prove to be critical when a project has to be implemented within a rigid timetable. Delays in appointments due to the need to conform to equality of opportunity and other human resource requirements could lead to subsequent difficulties in meeting the implementation timetable for similar projects (paragraph 2.9).

6. In our view the target for the completion of the procurement phase of the project was optimistic. As paragraph 2.12 shows, the evidence that is now available on PFI projects confirms that the

procurement phase for a project of the size and complexity of the AAP was unlikely to be achieved within a seven month timeframe. A reduced timeframe increases the risk that a project such as AAP will not be completed on time and/or in accordance with specifications. Future projects should note that this stage is likely to take longer than expected and should build this into their planning (paragraph 2.13).

7. We acknowledge that the Project Team took its decisions using the processes and information available to it. However, given the problems that beset the payroll module after the signing of the Agreement, we consider it important that the lessons learned from this experience are fed back into the evaluation process in order to enhance future screening criteria and to ensure greater implementation success in similar IT projects (paragraph 2.23).

8. During the evaluation of the supplier's bid, we found that the bidder did not provide details of the key staff either within its own organisation or its subcontractor's who would be involved during implementation of the project. We recognise that, due to the longevity of a contract such as the AAP, there is likely to be a high turn-over in the membership of the contractor's team. Moreover in a PFI contract such as AAP, the public sector's management processes will be performed differently to those in a traditional procurement due to the complex risk allocation between the parties. However, we would suggest that in future projects of this type, contracting authorities should not lose sight of the importance of the contractor's ability to provide the necessary personnel with the required experience and skills during the crucial implementation stage to ensure the success of the project (paragraph 2.25).

9. While it is clear that the Contractor failed to meet the specified requirements for payroll and human resources services under the agreement, in our view, the late inclusion of a complex payroll /human resources requirement in the specification for the project by the Boards' Information Systems Development Committee (see paragraph 2.5) increased the likelihood that the contract would not be met in full. In the first place, adding to the scope of a project can compound delays and affect the delivery of the original project aims. This becomes particularly important when the implementation timeframe is fixed and offers little flexibility for project delay. Secondly, the report by the Committee of Public

Accounts at Westminster in 1993 (see paragraph 1.8) records the problems the Boards experienced in trying to integrate their previous payroll and human resources systems. While this related to difficulties experienced in 1987-88 and there have been significant advances in technology since, we note the view of the South Eastern Board's Internal Audit Branch that the most obvious lesson arising from the AAP is that the difficulties with implementation of the previous payroll system were not adequately considered in the specification of the new system (paragraphs 3.14 and 3.15).

10. We consider that the Office of Government Commerce (OGC) guidance is pertinent to PFI projects across the public sector in Northern Ireland. In particular, we believe that if departments apply the "Gateway" review process (see paragraph 3.19) to any future IT projects it should help to ensure that risks are appropriately allocated and that the level of system implementation problems such as those experienced in the Accruals Accounting Project are avoided (paragraph 3.21).

11. We acknowledge that, in difficult circumstances, the Project Board has succeeded in achieving the core aim of the project in establishing a system capable of producing accruals accounts and management information. Notwithstanding this, we consider that there were weaknesses in the reporting and monitoring arrangements - which may have implications for similar projects in the future. Insufficient management reporting over a sustained period could curtail the ability of a sponsoring Department to trigger timely action should circumstances merit it. At the same time, we also take the view that implementing a system like AAP, within a demanding timetable, should require a more proactive, hands-on approach by the sponsoring Department. Perhaps designating a more formal role for the Department on the Project Board during this stage would have added to the overall strengthening of the project management discipline. In this context, the weaknesses in monitoring identified by the Westminster Committee of Public Accounts in 1993 (see paragraph 1.8), albeit in a conventional procurement process, has relevance for future projects (paragraph 3.25).

12. We consider that the current outcome of the project demonstrates the need for contracting authorities to be wary of over-ambition when seeking to apply PFI as a solution to complex IT projects (paragraph 4.4).

13. We consider it essential that in all PFI projects, public sector bodies should ensure that external advisers are working to a clear specification and within an agreed timetable for completion of the work. We note that an Information Memorandum produced by the Department in July 2000 on its experiences of managing PFI contracts in school building projects also called for "...much tighter control and shorter time-scales" in relation to the use of consultants in future PFI projects (paragraph 4.10).

14. The Project Board has indicated that a significant degree of skills transfer has been achieved as evidenced by the on-going work of the current project support team. In our view, the transfer of skills within a project such as AAP should take place on the basis of detailed planning as to how and when needed competencies would be passed on. We consider that in any future project the transfer of skills should become a central and deliverable component in consultancy appointments in order to ensure that the pace of skills transfer is timely and contracting authorities achieve and sustain the level of competencies required (paragraph 4.12).

15. It is good practice that payment is not due or justified unless and until services have been received from a contractor. While the contract allowed part payment of any disputed invoice, we found no evidence to suggest that the Board had considered paying a reduced amount because the full Accounting Service was not initially available. It would appear that the Project Board was only contractually bound to pay a maximum of £600,000 following the service trial of the system. In the event, as a result of the CCN 6 Agreement, the Contractor was paid £800,000 in respect of accounting services up to the stage that the pilot Board went live. The Project Manager assured us that the Project Board had sought legal advice as to whether it should pay amounts other than those contained in the original contract, but we found no documentary evidence of this advice (paragraph 4.15).

16. Under the Agreement payments to the Contractor are based on the level of performance it provides. As a result, accurate and transparent reporting is critical to ensuring that the Project Board receives value for the money it spends on the implementation and operation of the new accounting system. In view of this, NIAO recommends that the Project Board should, as a matter of urgency, obtain agreement with the Contractor on the final version of the

Service Code of Practice, formally documenting the reporting mechanism which the Department told us is already in place (paragraph 4.23).

17. We were told by the South-Eastern Board that the decision to proceed with the PFI solution was influenced by projected staff, maintenance and software licence savings of almost £6 million over the course of the original contract period. The anticipated annual savings which were associated with the payroll element of the project, have not been realised to date. In view of the deferred benefits, the Department told us that the Boards have effected savings in their Headquarters services because the funding provided by the Department for the project was net of projected annual savings and Headquarters budgets were reduced to reflect this. We acknowledge the Department's comments on the reduction in Headquarters expenditure and note their claim that this was done without having a detrimental effect on the provision of Board services. However, it is important to realise that what has happened in this case is that an element of the annual efficiency savings which were originally anticipated, have had to be offset against this project instead of being available for service provision in other areas. The business case identified specific efficiency savings to justify the PFI deal. It is worth emphasising that this is an important feature of PFI projects and there needs to be a clear methodology to monitor those savings and demonstrate whether or not they are achieved (paragraphs 4.24 to 4.27).

General Observations in relation to Future Projects

18. Our experience in reviewing this project has pointed up a number of important issues which need to be borne in mind for future public-private partnerships, particularly those involving Information Technology (IT).

PFI and IT Projects

19. Our examination of the AAP showed that the application of PFI to IT is very different from its application to a tangible asset such as a school. In the case of the AAP, it delivers value indirectly by producing financial information in a new way. Value is delivered, not by the technological components, but by the knowledge and skills applied to integrating them with each other,

and integrating the resultant systems with people and processes of the Education and Library Boards.

20. An IT system such as the AAP will also have a strikingly different life-cycle from that of a capital asset like a school. A school built ten years ago will still be in use today and will look much the same as when it was built. Within IT, however, change is an ongoing process. Thus it may not be enough merely to maintain and modernise the AAP's components, during the course of the PFI Agreement, it may also be necessary to absorb new technologies.

21. In our view these factors do not mean that PFI is necessarily the wrong approach for IT. However, we consider that it does mean that the degree of complexity and risk involved is likely to be greater, for example, than that present when specifying a new school. As a result, there is a greater requirement on those managing an IT PFI process to ensure that the contractor delivers the service over the full duration of the contracted period.

Option Appraisal

22. In procuring a system like the AAP, the primary concern is that the Education and Library Boards should secure the best available deal. While PFI can be viewed as an appropriate solution where there are significant risks of escalating costs and uncertainty in the funding available for public sector capital projects, it is important to fully evaluate the suitability of schemes for inclusion in the PFI process. Identifying and assessing as full a range of options as possible for IT projects is essential to ensuring that value for money is achieved.

Specialist Skills

23. The experience of the AAP has been that the shortage of PFI-specific skills and resources is likely to be more acute in non-departmental public bodies such as the Education and Library Boards. They often have smaller staff numbers than central government departments and need to focus most of their resources on service delivery to the public rather than on internal management and system development. Thus they are less likely to retain the required specialisms in-house. As with the AAP, this

skills gap can be partially filled - at a significant cost - through appointing specialist advisors for the project. However, there is a need to avoid over-reliance on advisors by ensuring that skills transfer takes place in a timely way allowing the specialist advisors to withdraw.

Project Scope

24. Much of the risk attached to IT projects arises from their scope. Introducing an integrated accruals-accounting system into the five Education and Library Boards was a huge, complex and ambitious undertaking. However, the decision, following the initiation of the project, to include a personnel option which included payroll related systems increased the risks that the main project might not be delivered on time. We note that the Department cautioned against this approach and, in the event, the payroll and human resources modules were not supplied by the Contractor. In spite of this, the other elements of the project proceeded according to plans.

Expected Benefits

25. Value for money in an IT PFI project depends on more than just price. In a construction project, for example, it is quite evident that the client has an enduring valuable asset at the end of the project. The value for money indicators in IT projects lie around less tangible issues such as greater operational efficiency. For instance, part of the justification in the original Business Case for the PFI approach to the AAP was the identification of projected staff, maintenance and software licence cost savings of £6 million over the duration of the Agreement. The removal of the payroll/ human resources element significantly negated the generation of these savings to date and has deferred their potential achievement until the outcome of the further project to improve the existing payroll system. However, having quantified a value of savings expected, achieving that value must be a prime consideration for the client . When procuring a step change in technology such as the AAP, it is essential to develop mechanisms to ensure that the cost savings or other benefits are obtained for what will be a considerable investment of public money.

Sub-Contractors

26. In the case of the AAP, the main contractor sub-contracted the payroll software work, which in the end was not supplied and removed from the contracted service . The sub-contractor's inability to meet the requirements of the payroll systems, which is entirely a matter between them and the contractor, has, in practice, caused major problems for the Project Board. While the main contractor was totally responsible, with the transference of risk, for the sub-contractor's performance, we consider that it is legitimate that contracting authorities should satisfy themselves that the prime contractor's arrangements for managing sub-contracts are effective in ensuring that the full requirements of the overall contract are met.

THE PFI CONTRACT FOR THE EDUCATION AND LIBRARY BOARDS' NEW COMPUTERISED ACCOUNTING SYSTEM

Part 1: Introduction and Scope

1.1 In January 1999 the South Eastern Board, on behalf of the five Education and Library Boards, signed a contract to provide an integrated accruals-based accounting system capable of recording all the Boards' financial transactions, producing their annual accounts and internal financial management information. The cost of implementing the AAP, over ten years, was projected to be £20.2 million at 1998-99 prices[3]. Forecast financial savings in the same period, mainly in the form of staff savings across the five Boards, from the implementation of the new systems were around £6 million at 1998-99 prices.

Private Finance Initiative

1.2 The contract signed by the South-Eastern Board was a Private Finance Initiative (PFI) Agreement (the Agreement). The Board told us that PFI was in line with the government's policy which required that any capital investment providing services to the public sector had to be assessed prior to any public investment to see if the private sector could offer a more economic means of procurement.

1.3 PFI offers a radically different approach to traditional public sector procurement in that the purchase of major assets and associated services is accomplished within a long-term contract, under which the initial capital outlay is financed by the private sector. A key objective of PFI is to bring private sector management expertise, and the disciplines associated with private ownership and finance, into the provision of public services. The Audit Commission[4] has identified the fundamental features of a PFI contract that contribute to value for money. These are summarised in Appendix 1.

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3 1998-99 prices were calculated using the discount rate of six per cent recommended by HM Treasury for translating the expected benefits and costs in future years into present value terms in the appraisal of public sector investment projects.

4 Building for the Future: The Management of Procurement under the Private Finance Initiative, Audit Commission, 2001.

1.4 If PFI is to deliver value for money to the public sector, the higher costs of private finance and the level of returns demanded by private sector investors must be outweighed by lower design, implementation, management and operating costs. Within PFI, the relationship between risk, value for money and affordability is one of the most complex and controversial issues. In developing the business case for a PFI project the prospective purchaser endeavours to identify all the risks associated with a project and how they are to be allocated between the purchaser and the provider. Bids are then invited from the private sector to provide services according to the suggested risk allocations.

1.5 Under the Agreement, substantial risks have been transferred to the contractor which would have been borne by the Boards in a conventional procurement. Figure 1 summarises the allocation of risk.

Figure 1: Risk Allocation

Type of Risk	Boards	Contractor
Design and Development	None	Design and development risk rests with the contractor through the payment mechanism.
Delivery	Late or non-delivery severely affects the Boards' business. The discharge of their financial obligations will be compromised and they will be unable to continue with existing cash-based accounting arrangements. Expected savings will not materialise.	Financial risk of non or late delivery rests with the contractor through the payment mechanism.
Finance	None	Finance provided by the contractor.
Operation	Business risk rests with the Board as above.	Contractor to bear a financial risk of below standard operation through the payment mechanism.

Source: NIAO

1.6 In a conventional IT procurement, the customer bears much of the financial and business risk of the development work failing or being delayed. In the PFI Agreement the Boards expected to transfer the risk associated with financing the design, development and delivery of the system. Indeed, the Agreement contains a specific clause requiring the contractor to arrange all necessary resources at its own expense to produce accruals accounts. However, the Boards retain the risk to the successful operation of their financial accounting function should the Contractor be unable to deliver. The Agreement does however contain safeguards as the Boards can claim, up to an agreed limit of £15,000 per week for a maximum of 8 weeks, for additional operational and administrative costs incurred should the Contractor default on the contract.

Accountability for the Project

1.7 Responsibility for the Accruals Accounting Project is shared between the South-Eastern Board and the Department. The Chief Executive of the South-Eastern Board is responsible for implementation of the project. The Permanent Secretary of the Department, as overall Accounting Officer, is ultimately responsible for ensuring that the Project is completed on time and within budget.

Previous Examinations by the Public Accounts Committee

1.8 In July 1993, the Committee of Public Accounts at Westminster reported on "The Education and Library Boards Information Technology Strategy" (Fiftieth Report, Session 1992-93 CM341). This report focussed on the IT strategy which the Department had implemented in 1985. The Committee's recommendations spanned a series of issues such as strategy formulation; procurement; project control and post-implementation evaluation. In particular, it drew attention to the need for effective control over the use of consultancy support and for departments to closely monitor the activities of the non-departmental government bodies that they fund and for which they are responsible. Appendix 2 provides a summary of the Committee's conclusions and the issues that it addressed.

Good Practice Guidance

1.9 While advice and guidance has been available from HM Treasury and the Central Computer and Telecommunications

Agency (CCTA)[4] since the inception of PFI, we note that additional guidance has been issued following the commencement of AAP. In 1999, the Treasury Taskforce (now Partnerships UK) issued guidance[5], which deals generically with PFI procurement. In addition, it commissioned a review, published jointly by the London School of Economics and Arthur Andersen[6], which provides a broad-based survey of operational PFI projects.

1.10 In January 2000, the Committee of Public Accounts at Westminster in their report on "Improving the Delivery of Government IT Projects" (First Report, Session 1999-2000) drew together lessons to be learned from a wide range of projects previously examined by the Committee. As part of the Modernising Government initiative, the Cabinet Office published good practice guidance[7] specifically on information technology projects. This made detailed recommendations covering all aspects of the management of such projects from leadership and project management to the learning of lessons after completion of a project. To ensure that change would be delivered the Office of Government Commerce (OGC) introduced a "Gateway" independent pre-contract review for major projects involving IT (see paragraph 3.19).

1.11 Locally, the Assembly's Committee for Finance and Personnel produced a report[8] in 2001 which outlines a number of advantages and disadvantages in using Public Private Partnerships (PPPs)[9] and identified a range of good practice measures intended to help determine value for money in any planned programme of investment. We also note that the Assembly Executive has considered a report prepared by representatives from the public and private sectors, the voluntary sector and the trade unions on *The Opportunities for Public Private Partnerships in Northern Ireland.* This report examined what place Public Private Partnerships should have in the Executive's strategy to address the infrastructure deficit.

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4 As from 1 April 2001, CCTA became an integral part of the Office of Government Commerce.

5 Standardisation of PFI Contracts, Treasury Taskforce, 1999. This guidance changed the recommended contractual framework, the balance of risk between parties and the accounting guidance for PFI projects. The Project Board told us that it was taken into account when it was negotiating changes to the existing Agreement.

6 Value for Money Drivers in the Private Finance Initiative, Enterprise LSE/Arthur Andersen, 2000

7 Successful IT, Modernising Government in Action, 2000.

8 Report on the Inquiry into the Use of Public Private Partnerships, Committee for Finance and Personnel, June 2001, NIA7/00.

9 PFI projects fall within the definition of PPPs, which is a wider term that includes other types of joint venture. PPPs evolved from PFI as a result of Government reviews and are potentially more flexible in structure and form.

Scope of Study

1.12 This is one of the earliest and largest IT PFI projects undertaken in Northern Ireland. Given the significance of the operation of a financial management information system to the successful administration of the Boards, the purpose of our report is to examine the management and delivery of the project to date:

- Part 2 examines the initial option appraisal process and how the procurement process was managed;
- Part 3 focuses on the management and control of the implementation of the project; and
- Part 4 examines the costs incurred, in particular consultancy support.

1.13 Our report also endeavours to identify and highlight lessons that could assist the Department and other public bodies in dealing with third party contractors, either in the context of systems design and implementation or overseeing PFI contracts.

1.14 We engaged the National Audit Office (NAO) to provide specialist advice on the way the Accruals Accounting Project Board handled the preparation of a Public Sector Comparator (Paragraph 2.8). This is a calculation which is based on the cost of the Project if it were to be created and managed wholly within the public sector, and the assumption that all the risks associated with the scheme are borne by the purchaser.

Part 2: The Procurement Process

2.1 In July 1997, the Treasury Taskforce produced a "14 Step Guide to PFI Procurement" which provides an overview of the process of procuring services under PFI (see Appendix 3). It describes each stage of the process, indicating what appraisal needs to be done and what decisions have to be taken. A sound procurement should be supported by a robust business analysis. The business case for a PFI project, or equivalent appraisal of the project, will develop through the procurement process. But it is important to know what to do at each stage. Although the procurement phase began in March 1997, four months before the issue of this guidance, we have used it to make an assessment of how well the procurement process was managed.

Option Appraisal

2.2 By the mid-1990s, the cash accounting systems used by both the Department and the Boards were unable to meet a Government requirement[10] that commercial style, accruals-based accounts were to be produced from the financial year 1999-2000. Driven also by the requirements of Compulsory Competitive Tendering, in May 1995 a review was initiated by the Information Systems Strategy Executive Committee (ISSEC) to examine how commercial-style accounting should be introduced. A Common Accounting Project Board (CAPB), chaired by the Department, was established to oversee this process.

2.3 The CAPB concluded that the Department and Boards should proceed along different procurement routes. The Department said this decision was taken because of the differences in the requirements for the Department and the Boards, and a greater urgency in the Department's implementation schedule. The solution for the Department was a "facilities management" approach using a software supply framework agreement that had been in place since 1993. This enabled government departments to "call-off" the software and services needed.

10 Non Departmental Public Bodies (NDPBs) like the Boards fell outside the "Departmental Boundary" defined in the Green Paper "Better Accounting for the Taxpayer's Money: Resource Accounting and Budgeting in Government." However, guidance stated that it would be consistent with the Paper's aims if NDPBs were to move towards preparing accounts on a commercial basis within the same timescale as Departments.

2.4 The Department told us that the Boards were precluded from using the software supply framework agreement. It added that not going out to competition would have been a breach of procurement rules by the Boards. For the Boards project, therefore, it was proposed that the procurement should be in accordance with an EC Directive which allowed for either PFI or conventional responses. This was in line with Government policy which stressed that in order to maximise value for money, PFI should be examined in the first instance to indicate whether a successful outcome could be achieved by this route.

Project Initiation

2.5 The procurement phase for the project began with a Project Initiation Document which was submitted to the Boards' Information Systems Development Committee (a sub-committee of ISSEC), in February 1997. This Document provided a high level understanding of what was required from the project. However, following its consideration, the Committee issued a directive to the Project Board, extending the scope of the project to include a personnel option providing for additional human resources and payroll related systems.

2.6 Following the Project Initiation Document, an Outline Business Case was prepared which calculated the timescale and budget for the project. This was approved by the Department of Finance and Personnel in May 1997. The Outline Business Case defined the objectives for the Project as being to:

- introduce accruals accounting to the Boards by 1 April 1999;
- provide related financial management information systems;
- provide on-line access to financial and management information to allow managers to analyse the costs and budgets of their own responsibility areas; and
- comply with the IT Strategy's defined technical policies and standards.

The Procurement Team

2.7 It is vital in the thorough planning of the procurement of a PFI deal to assemble a properly qualified project team in good time. Best practice suggests that, wherever possible, internal members of the team should include people with previous experience of negotiating PFI deals. In the case of the AAP, this was not possible as it was the first time the Boards had been involved in such a project. As regards external advisors, procuring authorities should seek to appoint advisors with previous successful experience of PFI work.

2.8 The review completed in December 1995 (see paragraph 2.2) had indicated that the target of introducing commercial-style accounts to the Boards by April 1999 was ambitious. A Project Board to manage the procurement process was established in March 1996. However, the Board told us that, having agreed a methodology for recruiting and appointing a Project Team, it had to change this approach in light of human resources advice received on issues of equality and fair employment. Despite an internal and subsequent external competition, no appointment of a Project Manager was made. A number of preferred suppliers were then invited to tender for this work and an external consultant was appointed to act as Project Manager in December 1996 for the procurement stage. Further problems were encountered in the recruitment of project team members from within the Boards. However, the consultant was subsequently joined by two full-time Board staff, supplemented by additional consultancy support and input from other Board staff with expertise in specific aspects of the process.

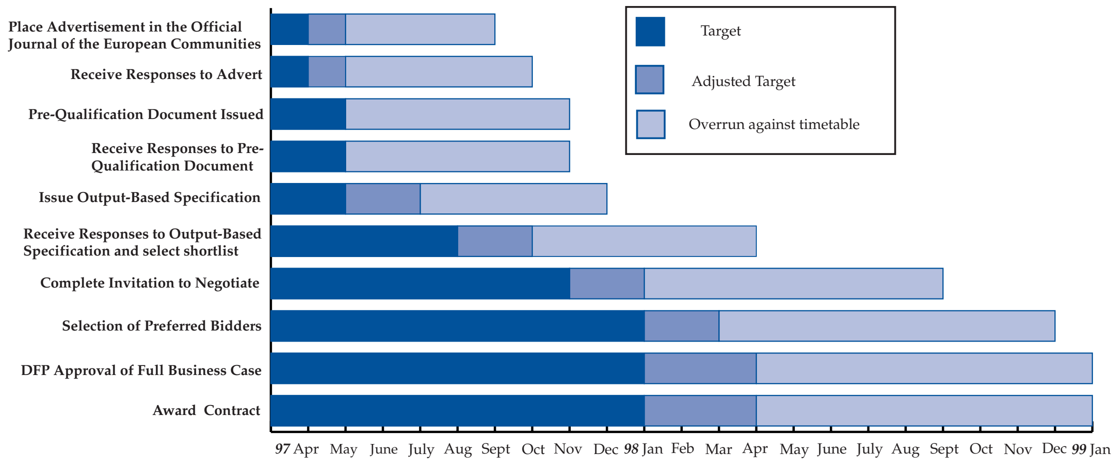
2.9 The availability of key personnel is a specific risk in a PFI project. Treasury Taskforce guidance emphasises that it is wise to plan for a strong team from the start, with relevant experience drawn from both inside and outside the client's organisation. The experience of the AAP shows that an issue such as the timely appointment of a Project Team could prove to be critical when a project has to be implemented within a rigid timetable. Delays in appointments due to the need to conform to equality of opportunity and other human resource requirements could lead to subsequent difficulties in meeting the implementation timetable for similar projects.

Market Sounding

2.10 Once the procurement process began, the Project Board applied good practice in maximising competition. In March 1997 it placed a Preliminary Indicative Notice in the Official Journal of the European Communities (OJEC) inviting suppliers to register an interest in the Project. Some 42 firms responded and were issued with a prospectus. As a result of this market sounding exercise the Project Board concluded that there was sufficient interest for the delivery of a solution to the Boards under PFI. Although the Department of Finance and Personnel approved the Outline Business Case on that basis in May 1997, the procurement process was delayed until the Chief Executives' concerns over the PFI process, in particular the employment rights of staff, were resolved by the issue of a Departmental letter instructing the Boards to proceed. The procurement was formally advertised in the OJEC in September 1997.

2.11 The initial timetable envisaged that the OJEC advertisement would be placed in April 1997 with the contract awarded by January 1998. Although the procurement process commenced six months behind target, the revised timetable envisaged that the contract would still be awarded by April 1998. In the event, contract negotiations were completed in October 1998 although the PFI Agreement was not signed until January 1999, 14 months after the procurement was advertised. Figure 2 sets out the target and achieved timetables.

Figure 2: Procurement Timetable for the Accruals Accounting Project



Source: NIAO

2.12 It is now recognised that a key feature of PFI schemes is that it takes a long time to negotiate deals to a successful conclusion, and almost always longer than expected. Evidence gathered by the Audit Commission[11] (see paragraph 1.3) suggests that bodies considering a PFI deal should do so in the expectation that the scheme is likely to take between 12 months and two years to move from advertisement in the OJEC to contract closure.

2.13 In our view the target for the completion of the procurement phase of the project was optimistic. As paragraph 2.12 shows, the evidence that is now available on PFI projects confirms that the procurement phase for a project of the size and complexity of the AAP was unlikely to be achieved within a seven month timeframe. A reduced timeframe increases the risk that a project such as AAP will not be completed on time and/or in accordance with specifications. Future projects should note that this stage is likely to take longer than expected and should build this into their planning.

Shortlisting of Bidders

2.14 The Project Team carried out a thorough pre-qualification process for selecting potential contractors. Having received 31 expressions of interest to the formal advertisement it carried out an evaluation of the responses. Information was collected on the economic and financial standing of bidders and their technical capacity and ability to deliver the requirements. Of the 31 bidders who were issued with the Pre-Qualification Document, only four responded.

2.15 At this stage one of the four bids was withdrawn. This was because the Board felt that the response from this bidder did not provide a satisfactory basis for detailed contractual negotiations. A detailed Output Based Specification (informing the market what requirements had to be met) was issued to the remaining three bidders in December 1997. Proposals were received from only two of the three, one withdrawing due to a conflict of interest.

11 "Building for the future: The Management of Procurement under the Private Finance Initiative." Audit Commission, 2001.

2.16 A Bid Evaluation and Negotiation Team (BENT) was established, to consider in detail the bidder proposals, to conduct negotiations and make recommendations to the Project Board. Purchasing, legal and financial advice was provided by Consultants and CCTA and its legal advisers. A compliance review was carried out by BENT on the remaining two completed Output Based Specifications to ensure that all of the requirements had been met and that the documentation submitted was complete and accurate. Both bidders passed the review.

2.17 Following discussions with the Project Board Chairman, and members of BENT, one of the two remaining bidders withdrew from the procurement process due to concerns they had over continued participation in the project. The reasons cited by the bidder included:

- Concerns over their ability to meet the implementation timescales;
- Potential difficulties were foreseen in implementing the applications in five different Board areas; and
- The timetable for implementing the necessary business process changes was considered to be too tight.

The Project Board told us that these risks were known to it and were included in the risk register for the Project.

2.18 Consequently the Project Board was left with only a single bidder and was unable to maintain competitive tension in the bidding process. Despite this lack of competitive pressure, the Project Board decided to proceed with negotiations. This decision was taken after consultation with CCTA, and because a value for money test would remain as the bid would be evaluated against an alternative publicly funded option - the Public Sector Comparator.

2.19 Whilst competitive tension in contract negotiation is considered key to obtaining and demonstrating value for money in procurement, the use of a single bidder is not unique. The National Audit Office has reported that, for example, within the National Health Service in Great Britain, three of 14 PFI hospital projects[12] had proceeded on the basis of a single bid.

12 The PFI Contract for the New Dartford and Gravesham Hospital, National Audit Office, May 1999, HC 423.

Evaluation of the Overall Bid

2.20 BENT adopted a sound approach to the evaluation of the remaining bid. Initially the Team attended a series of demonstrations by the bidder and its sub-contractor, who were supplying the software to operate the payroll module of the system. In addition, the Team visited a number of sites where similar systems were in operation. The business requirements of the bidder's proposal were then evaluated against the Output Based Specification previously submitted. The evaluation was based on CCTA guidance, and applied weightings and scores to predetermined evaluation criteria.

2.21 While the BENT team concluded that the bidder's Output Based Specification represented an overall "high degree of fit" with the Project, a number of concerns were raised in an interim evaluation report presented to the Project Board by the Team in September 1998. These concerns related to both the bidder's own software for operating the accounting elements of the system and the sub-contractor's payroll software.

2.22 In view of the subsequent problems with the payroll module, the concerns expressed about this element are of particular interest. Users at the sites visited by the Team had expressed concern about the level and quality of support provided during the implementation and post-implementation phases of their systems. Implementation plans were thought to be ambitious, on-site support during implementation was sparse and in some instances the resolution of faults was not easily achieved. Despite such soundings, the Team were satisfied that, on the basis of CCTA guidance and advice, the track record and longer term financial viability of the contractor indicated that the overall proposal would meet the Boards' requirements. Against this background, it was considered that from demonstrations and reports from the sites visited, in general, the payroll software operated satisfactorily.

2.23 We acknowledge that the Project Team took its decision using the processes and information available to it. However, given the problems that beset the payroll module after the signing of the Agreement, we consider it important that the lessons learned from this experience are fed back into the evaluation process in subsequent projects in order to enhance future screening criteria and to ensure greater implementation success in similar IT projects.

Evaluation of Project Management Proposals

2.24 PFI has been introduced in the public sector partly on the grounds that the private sector should have the project management skills to deliver capital projects on time and within budget. In addition, the private sector is expected to be able to offer the general management skills to operate long-term service contracts economically, efficiently and effectively. Against this background the Business Case contained assessment criteria for evaluating project management arrangements based on CCTA guidance. These covered financial, technical and operational issues and included consideration of the experience and expertise of the suppliers' key management personnel associated with the project and their ability to manage and deliver the project in accordance with the authority's requirements. On the basis of its overall evaluation, the Project Team concluded that the contractor had the necessary capability to deliver the project to the required standard.

2.25 During this stage of the procurement process, we found that the bidder did not provide details of the key staff either within its own organisation or its subcontractor's who would be involved during implementation of the project. We recognise that, due to the longevity of a contract such as the AAP, there is likely to be a high turn-over in the membership of the contractor's team. Moreover, compared with a traditional procurement, we acknowledge that, in a PFI contract such as AAP, the public sector's management processes will be performed differently due to the complex risk allocation between the parties. However, we would suggest that in future projects of this type, contracting authorities should not lose sight of the importance of the contractor's ability to provide the necessary personnel with the required experience and skills during the crucial implementation stage to ensure the success of a project.

Public Sector Comparator

2.26 The usual way of establishing that a privately financed project is likely to provide value for money is to carry out a systematic financial comparison of the project with a realistic alternative. The preparation of a Public Sector Comparator (PSC) provides a benchmark against which value for money is assessed. It is typically a cost estimate based on the assumption that assets are acquired through conventional funding and that the procurer retains significant managerial responsibility. To be a valid benchmark against which the private sector bid can be compared, the PSC must not only reflect the estimated costs but also the risk that additional costs may arise which, under PFI, would fall to the supplier.

2.27 The PSC for the Project was based on the installation of five distributed servers (one at each Board) with access for users in each Board via personal computers, linked to local area networks. The Project Board compared this arrangement with the bidder's Best and Final Offer made in October 1998. The Board estimated that a PFI contract, over ten years, would cost £20.2 million which was considerably below the PSC.

2.28 As outlined at paragraph 1.14 we engaged the NAO to review the PSC. In general, it found that the preparation of the PSC was soundly carried out. The financial evaluation completed by the Project Team demonstrated that the standard bid (an agreement duration of ten years with an option to renew for a further three years) offered the best value for money.

2.29 Of course, the extent to which predicted savings are actually delivered will only be demonstrated over the longer term. In the short term, purchasers can only rely on the PSC to demonstrate value for money and, while the PFI arrangement can generate significant predicted savings, it is not guaranteed.

Best and Final Offer

2.30 Following a series of negotiation and clarification meetings in September 1998, a draft contract was drawn up. In October 1998 the Project Board invited the supplier to submit a Best and Final Offer (BAFO). The BAFO was evaluated by the Team and the results presented to the Project Board in November 1998. It was agreed that, subject to approval from the Department and the Department of Finance and Personnel (DFP), the Board should proceed to the final stage of exchanging contracts. DFP approved the Full Business

Case in December 1998 and the PFI Agreement with the Contractor was signed on 17 January 1999.

Services to be Provided Under the Agreement

2.31 The PFI Agreement provided for the development and operation of a new IT system to support the Boards' financial and management accounting needs. It incorporated the following elements:

- budgetary control;
- income processing;
- purchase ordering and payments;
- payment of travel and subsistence claims;
- cash management;
- accounting for fixed assets and stores;
- payroll calculation and payment processing for all Board employees; and
- office automation.

In addition, the new system was intended to provide information to and receive information from a variety of other Board computerised systems.

2.32 The PFI Agreement with the Contractor was signed by the South Eastern Board (on behalf of the five education and library boards) in January 1999. The term of the Agreement was expected to be twelve years (i.e. ten years after the final service trial tests) with an option to renew for a further three years. The projected cost was £20.2 million over the first ten years.

Part 3: The Implementation Process

3.1 The management of the contract is a distinct process which follows on from procurement. An Implementation Project Board (the Project Board) was established in January 1999 to oversee the strategic direction of the implementation process. In this Part of the Report we examine the effectiveness of the management and control of the Project throughout this phase.

3.2 Following the signing of the Agreement, a Project Initiation Document (PID) was approved by the Project Board in March 1999. This set out the planned approach to the delivery of the Project including the products, activities and resources required. Due to the challenging time scale of introducing accruals accounting to the Boards the PID proposed that implementation would be on a phased basis (see Figure 3), in line with the outline timetable included in the Agreement.

Figure 3: Phased Implementation of the Project

PHASE	Accounting Services
ONE	General Ledger, Accounts Payable, Accounts Receivable to Boards
TWO	Fixed Assets, Oracle Inventory, Oracle Purchasing to Boards

PHASE	Payroll/Human Resource Services
ONE	Payroll and Travel & Subsistence to Pilot Board (South-Eastern)
TWO	Payroll, Travel & Subsistence to all Boards
THREE	Human Resources to all Boards

Source: Project Board

3.3 The Agreement set out target dates for the delivery of Service Trial Tests for both Accounting and Payroll Services. The objective of Service Trial Tests is to certify that the services provided by the

Contractor satisfy the criteria specified in the Agreement. However, the Project encountered a number of early difficulties. The key difficulties are summarised below:

Figure 4: Overview of Initial Problems During Implementation

Accounting Services	Payroll/Human Resource Services
• Delays with receipt of some aspects of the software • Problems with software functionality and potential loss of efficiency savings • Under-development of management reporting and enquiry facilities • Instability of the service infrastructure • Late completion of the Contract Service Trial	• Lack of understanding by Contractor and their sub-contracted payroll software supplier of the requirement • Key business requirements required software modifications • Contractor repeatedly missed their delivery dates for key software modifications • Considerable re-planning of the project was required • Lack of available Contractor Software resources

Source: Project Board

3.4 In September 1999 CCTA, acting on the Boards' behalf, gave notice to the Contractor that it was in default of the Agreement as a result of the ongoing project delivery problems. The contractor did not accept this charge. Nevertheless through subsequent negotiations with the Boards, the Contractor agreed to make the necessary resources available to enable the project to proceed. This began a process to change the terms of the original Agreement of January 1999.

Change to the Agreement: Change Control Note 6

3.5 Over the life of a PFI Agreement not all possible changes, whether in the purchaser's requirement or the contractor's ability to deliver that requirement, can be foreseen. As a result, PFI Agreements need to contain a mechanism by which changes may be proposed by either party and evaluated and approved prior to implementation. That evaluation will also need to consider the impact of change on the value for money of the deal, how the change will be priced and how costs and savings should be apportioned.

3.6 This process led to Change Control Note (CCN) 6 [13] in April 2000 which committed the Contractor to a revised timetable for the term of the original Agreement. The effect was a six month delay in the implementation dates established in the original ten year Agreement. Figure 5 provides a comparison of the original Agreement (revised to take account of 1999-2000 prices) and the changes agreed under CCN 6.

Figure 5: Comparison of the Original PFI Agreement and Change Control Note 6

Year Ended 31 March	AAP Agreement Net Charges £000	CCN6 Net Charges £000	Saving/ (Cost) £000	Additional Services/ (Credits) £000	Total Variance £000
2000	2,410	1,977	433	120	553
2001	3,377	3,911	(534)	260	(274)
2002	2,953	2,157	796	20	816
2003	2,580	2,107	473	20	493
2004	1,891	2,057	(166)	20	(146)
2005	1,844	1,957	(113)	20	(93)
2006	1,805	1,907	(102)	20	(82)
2007	1,767	1,857	(90)	20	(70)
2008	1,731	1,786	(56)	20	(36)
2009	1,742	1,767	(25)	20	(5)
2010	2,062	1,757	305	20	325
2011	2,062	1,745	317	20	337
2011*	1,030	1,030	-	10	10
Total	**27,254**	**23,016**	**1,238**	**590**	**1,828**
NPV	**20,580**	**19,606**	**974**	**509**	**1,484**

Source: Project Board
*** (6 months only)**

13 Change Control Notes 1-5 dealt with minor changes to the Agreement

3.7 Figure 5 shows that CCN 6 reduced the projected costs by £1.828 million (Net Present Value £1.484 million) over the revised period of the contract compared to those established in the original Agreement. The £1.238 millon (NPV £974,000) reduction includes provision for compensation for additional costs borne by the Boards during 1999-2000 totalling £617,000. This was based on calculations that £325,000 was in relation to additional work undertaken by the Project Team and £292,000 for work carried out by the Project's external consultants.

3.8 CCN6 also included a £100,000 credit note and made provision for additional services that were outside the original Agreement. These included customisations, report writing and training for the Accounting and/or Payroll human resources systems and other hardware and licence costs (NPV £509,000).

The Decision to Go Live

3.9 The Service Trial Test for Accounting Services was performed by the Project Team in October 1999 and although there were some minor issues outstanding with the software, the trial passed the Service Trial criteria, in overall terms. There was, however, concern surrounding the reliability of the hardware. The Department told us that the Contractor assured the Project Board that problems surrounding the reliability of the hardware would be fully resolved and demonstrated their commitment by involving the hardware suppliers in their investigations and changes to the servers. The next stage in the process was a Pilot run in the South-Eastern Board carried out in November 1999, which resulted in very few issues being raised. This meant that the contractual date for the successful completion of the service trial test was not met. The Project Board decided that the new accounting system should go live in the South-Eastern Board in December 1999. This was done on the understanding that a partial live service was being accepted and that the outstanding issues would be resolved. Live running of the system then rolled out, following pilots, to the Southern and Western Boards in February 2000 and to Belfast and North-Eastern Boards in April 2000.

The Abandonment of the Payroll and Human Resources Modules

3.10 The Agreement included optional Human Resource services and it was agreed in February 1999 that these services would be implemented. The original implementation plan specified completion of the Service Trials for Payroll and Travel and Subsistence by December 1999 with the Personnel option to be completed by February 2000.

3.11 From early in the project it was understood that the payroll software suppliers would have to customise their software to deal with the full complexity of Board employees who were paid for performing a number of different jobs, such as bus driver/caretaker. The initial delivery of this software took place in August 1999, but preliminary testing revealed problems with its functionality. In September 1999, agreement was reached with the contractor that unless all of the problems were satisfactorily resolved by December 1999, the payroll implementation would be unable to proceed.

3.12 When the payroll service trials began in December 1999, it quickly became clear that the overall system was still failing to meet the requirements and some problems that had previously been resolved had re-appeared. As a result, the service trial was suspended. Following the signing of CCN 6 (see paragraph 3.6), which significantly altered the implementation time scale of the payroll and human resources modules of the system, the service trial recommenced in February 2000 and by May 2000 it became clear that the sub-contractor's software was still unable to meet the Boards' requirements.

3.13 Following the failure of this further service trial test, the Project Board accepted an option recommended by the Contractor to suspend the implementation of the payroll and human resources modules for a period of time and to stand down the teams working in this area. The Project Board subsequently recommended to the Chief Executives of the five Education and Library Boards that a review team should be established to look at how the difficulties around payroll and human resources could be resolved. However, the Chief Executives rejected this as a way forward and instead indicated that they would assume responsibility for developing an approach to payroll and human resources based on the existing system.

3.14 While it is clear that the Contractor failed to meet the specified requirements for payroll and human resources services under the agreement, in our view, the late inclusion of a complex payroll / human resources requirement in the specification for the project by the Boards' Information Systems Development Committee (see paragraph 2.5) increased the likelihood that the contract would not be met in full. Indeed, in April 1997, this issue was raised by the Project Board who told the Department it was concerned that the change to the scope of the project had increased the risk to the project and made the agreed timetable for procurement impossible to achieve. In addition, the Department told us during our review that it had also cautioned against the inclusion of payroll and human resources on similar grounds. The Department considered that, in spite of this, the other elements of the project proceeded according to plans.

3.15 Adding to the scope of a project can compound delays and affect the delivery of the original project aims. This becomes particularly important when the implementation timeframe is fixed and offers little flexibility for project delay. In 1993, the Committee of Public Accounts at Westminster (see paragraph 1.8) records the problems the Boards experienced in trying to integrate its previous payroll and human resources systems. While this related to difficulties experienced in 1987/88 and there has been significant advances in technology since, we note the view of the South-Eastern Board's Internal Audit Branch[14] that the most obvious lesson arising from the AAP is that the difficulties with implementation of the previous payroll system were not adequately considered in the specification of the new system.

Change to Agreement: Change Control Note 17

3.16 The abandonment of the Payroll/Human Resources modules required a further change to the Agreement. Following lengthy negotiations Change Control Note 17, agreed by the Project Board in December 2001, was signed in February 2002. As well as removing

14 A Review of the Implementation Phase of the Accruals Accounting Project, Internal Audit, South-Eastern Education and Library Board, March 2002.

Payroll Services and Charges from the Agreement, it was agreed that the Fixed Assets modules would be provided at a future date. The contract end date was extended a further six months, over one year past the original end date and was projected to cost £23.1 million (NPV £17.6m).

3.17 In agreeing the terms of the original Agreement the parties worked on the basis that approximately 400 workstations, together with associated infrastructure, services and licences would be required to provide Accounting Services and approximately 200 would be required to provide Payroll services. These were all put in place in time for live running. In light of the removal of payroll services from the Agreement, the parties agreed that the number of workstations should revert to the original 400 required for Accounting Services. However during the negotiations for CCN 17, the Project Board decided that the Boards required more workstations than originally envisaged for the Accounting Services. Consequently CCN 17 provided for the immediate payment of £2,813,000 for an additional 200 workstations to be used for Accounting Services. These were in fact the 200 workstations already in place for Payroll Services. In addition a quarterly service charge of £74,250 was payable over the term of the Agreement.

Partnership Management

3.18 The development of a successful relationship between the authority and the contractor will be assisted by the right contractual framework. This process includes allocating risks appropriately, establishing clearly defined quality of service and value for money mechanisms and building in arrangements to deal with change.

3.19 In November 2001 the National Audit Office produced a report examining the management of the relationship between authorities letting a PFI contract and the private sector PFI contractor[15]. The report emphasised that authorities and contractors need to consider how their relationship will be managed before the contract is let and failure to do this can lead to misunderstandings and difficulties in the early years of the contract. The OGC has also issued best practice guidance[16] that outlines the issues that should be considered in managing partnership relationships, in PFI and other deals, and the key questions to be asked. This approach is supported by the OGC "Gateway Process" that identified the

15 Managing the Relationship to Secure a Successful Partnership in PFI Projects,HC 375
16 Managing Partnership Relationships, Office of Government Commerce, 2001.

critical decision points in the development of a procurement project which should be reviewed by a team of experienced people, independent of the project team.

3.20 While this guidance postdates the early stages of the AAP an independent Review was completed in October 2002 to determine if the business benefits anticipated in the business case had actually been delivered. This review concluded that the vast majority of accounting user needs have been met. (See also paragraph 2 of Summary.)

3.21 We consider that the OGC guidance is pertinent to PFI projects across the public sector in Northern Ireland. In particular, we believe that if departments apply the "Gateway" review process to any future IT projects it should help to ensure that risks are appropriately allocated and that the level of system implementation problems such as those experienced in the Accruals Accounting Project are avoided.

Project Monitoring by the Department

3.22 As the sponsor of the Project the Department needs to ensure that it's financial and other management controls are appropriate and sufficient to safeguard the public funds spent on the project and, more generally, that those being applied by the Project Board conform with the requirements of good financial management. The Chief Executive of the South-Eastern Education and Library Board carries similar responsibility for the stewardship of public funds. In 1993, the Committee of Public Accounts at Westminster noted weaknesses in the monitoring role played by the Department in the progress of the Boards' IT strategy in 1987-88. It stressed the fundamental importance of all government departments monitoring effectively the activities of the non-departmental public bodies that they fund and for which they are responsible. Against the background of the successful completion of the main element of the Project and the delays and software problems encountered during the process we looked at how focused and effective the Department's monitoring of the Project was.

3.23 The Department was represented on the Project Board during the initiation and procurement phases of the Project. After the signing of the Agreement with the contractor in January 1999 the responsibility for the monitoring of the implementation of the Project and the attendant budget/ costs was placed in the hands of the Chief Executive of the SEELB as the contracting authority. The primary monitoring of expenditure by the Department was conducted through the standard monthly monitoring arrangements applying to Boards whereby they are required to report expenditure to date and identify any easements or pressures in relation to specific earmarked budgets such as that allocated for AAP. Additionally, the Department meets regularly with the Chief Finance Officers of the five Boards in the DE/Board Finance Group and reviews general financial issues relating to the activities of the Boards. This included regular discussion of the progress and difficulties being experienced during the implementation stage of the AAP. In terms of the overall project, the main reporting requirement was that the Project Board provide the Department with quarterly reports on the implementation of the project. However, a review of these reports found that they were high level summaries of progress which included little in the way of financial detail.

3.24 The information flow to the Department from the Project Board is dependent on the quality of reporting the Project Board receives from the Project Manager. Our review of papers at the South-Eastern Board shows that in the early stages of the Project costs were reported by the Project Manager to the monthly meetings of the Project Board. However, as implementation progressed reporting of the resource position on the project was not always timely and often not presented at the Project Board meetings. The South-Eastern Board's Internal Audit report (see paragraph 3.15) also records that budget and expenditure figures were not routinely reported in later Board meetings. However, the Project Manager has told NIAO that most costs were predictable on a monthly basis and that all potential variances were reported. However, the Department told us difficulties arose in predicting the future costs of the project in the periods of negotiation leading up to the changes made by CNN's 6 and 17 and in the accounting treatment of expenditure which would accrue when the budget changed from a cash budget to an accruals-based one.

3.25 We acknowledge that, in difficult circumstances, the Project Board has succeeded in achieving the core aim of the project in establishing a system capable of producing accruals accounts and management information. Notwithstanding this, we consider that there were weaknesses in the reporting and monitoring arrangements - which may have implications for similar projects in the future. Insufficient management reporting over a sustained period could curtail the ability of a sponsoring Department to trigger timely action should circumstances merit it. At the same time, we also take the view that implementing a system like AAP, within a demanding timetable, should require a more proactive, hands-on approach by the sponsoring Department. Perhaps designating a more formal role for the Department on the Project Board during this stage would have added to the overall strengthening of the project management discipline. In this context, the weaknesses in monitoring identified by the Westminster Committee of Public Accounts in 1993 (See paragraph 1.8), albeit in a conventional procurement process, has relevance for future projects.

Part 4: The Cost of Installing the New Accounting System

4.1 In this part of the Report we examine the actual costs incurred, as well as savings expected, by the Project Board in implementing the new accruals accounting system. In particular, we look at whether costs and savings were within the forecast contained in the Business Case and the Agreement and the reasons for any additional costs incurred or failure to achieve expected savings.

4.2 Figure 5 shows how, following CCN 6, the projected cost was reduced from £20.6 million to £19.6 million (in Net Present Value terms) and the duration revised to 2011. As a result of the abandonment of the payroll module, CCN 17 further revised the projected cost of the Agreement to £23.1m (NPV£17.6 million) and extended it to 2012 (see paragraph 3.16).

4.3 As shown above, the adjusted cost of the AAP is £3 million less than that originally contracted for, which reflects the abandonment of the payroll and human resources modules and the provision of additional workstations. By continuing with the existing payroll contract and using this in conjunction with the remaining modules of the AAP which had been delivered, the Project Board has been able to meet the core objective of the project by establishing a system capable of producing annual accruals accounts and management information.

4.4 We consider that the current outcome of the project demonstrates the need for contracting authorities to be wary of over-ambition in seeking to apply PFI as a solution to complex IT projects.

Implementation Costs Within the Boards

4.5 Figure 6 shows that, up to the end of March 2002, the Project Board had incurred implementation costs of some £1.3 million more than expected under the original Business Case due to the lack of suitable in-house resources and the problems experienced in implementing the new system as detailed in Part 3. At the same time, the re-negotiation of the contract under CCN6 (see Figure 5) resulted in reduced payments to the contractor.

Figure 6: Cost of Implementing the New Accounting System

	Total Expected Cost up to 31/3/02	Total Actual up to 31/2/02	Variance +/-
	£000	**£000**	**£000**
Implementation Costs			
Central Management Team	833	1,266	433
External Assistance	606	2,223	1,617
	1,439	**3,489**	**2,050**
Recurring Costs			
Consumables	123	64	-59
Additional Finance Staff	1,077	352	-725
	1,200	**416**	**-784**
Totals	**2,639**	**3,905**	**1,266**

Source: Project Board

Consultancy Support

4.6 The Business Case made provision for the use of consultants to meet gaps, as perceived at that time, in the skills and manpower available from within the Boards' own staffing resources. However, Figure 6 shows that consultants have been used on the project to a very much greater extent than initially envisaged and the recurring costs of additional finance staff were lower. The scale of costs incurred on consultancy has been heavily influenced by the need for legal advice and technical assistance due to the delays and software problems which beset the project's implementation. We acknowledge that some use of consultants was essential in these circumstances and that the Project Board received compensation for these additional costs under CCN6 (see paragraph 3.7). However, this has to be seen in the context that the project was failing to meet some of the requirements upon which the original approval was justified. After three years of the contract the cost of external assistance on the project stands at £2.2 million. The original forecast up to the end of this period was only £606,000.

4.7 While we were told that the rates charged by the main consultants are at substantial discount to their normal charges, the cost of individual consultants has been considerable. For example, a senior consultant appointed to provide management support cost the project £284,000 over the period 1999-00 and 2000-01. Indeed this senior consultant had been engaged almost full time on the project from January 1997 to October 2001.

4.8 As the Project Board had only appointed the main consultants for the Procurement phase of the Project a separate exercise had to be undertaken for support during the Implementation stage. Three bids were sought inviting tenders for the provision of consultancy support for the strategic and operational management of the Project. The Consultants who had managed the procurement stage of the project, were again appointed.

4.9 To guard against the possibility of excessive cost, purchasers must be clear about the proposed timetable for the involvement of consultants in a project and the likely volume of work before tendering. We found little evidence of effective control by the Project Board over the nature and scope of the use of consultants during the implementation phase. For instance, the letter of invitation issued by the Board to bidders did not specify the period of the proposed consultancy agreement. Rather, the proposal from the successful bidder assumed a two-year period for the agreement commencing in January 1999 and specified the level of input for individual consultants in terms of full time or part time provision. In addition, we found no evidence of formal Project Board approval for the appointment of the successful bidder as consultants to the project in advance of their appointment in January 1999. According to the Department, the Project Board had not met before the appointment which had to take place as soon as possible. Instead, the evaluation of the bidder was carried out by the five Chief Finance Officers of the Boards who form the majority on the Project Board.

4.10 We consider it essential that in all projects, public sector bodies should ensure that external advisers are working to a clear specification and within an agreed timetable for completion of the work. We note that an Information Memorandum produced by the Department in July 2000 on its experiences of managing PFI contracts in school building projects also called for "...much tighter control and shorter time-scales" in relation to the use of consultants in future PFI projects.

4.11 In the absence of tight control over the duration of consultancy appointments, there is a danger that the management of PFI projects could become over-reliant on the support and advice bought in at the expense of developing in-house capabilities. Indeed a key element in achieving and sustaining the level of service delivery required after consultants leave a project is the transferring of relevant skills to internal staff. The Project Board told us that need for skills transfer was incorporated into day to day planning rather than set out in a "Plan for transfer of skills", and that Education and Library Board staff are now operating the accruals accounting system without any input from consultants.

4.12 The Project Board told us that a significant degree of skills transfer has been achieved as evidenced by the on-going work of the current project support team. In our view, the transfer of skills within a project such as AAP should take place on the basis of detailed planning as to how and when needed competencies would be passed on. We consider that in any future project the transfer of skills should become a central and deliverable component in consultancy appointments in order to ensure that the pace of skills transfer is timely and contracting authorities achieve and sustain the level of competencies required.

Payments to Contractor

4.13 Payments to the Contractor commenced in November 1999 following the completion of the pilot run at the South-Eastern Board. Although the contract was under review at that time the original agreement stood. Nevertheless, payments were made based on the on-going commercial negotiations. Consequently, the Contractor was paid £800,000 in respect of accounting services up to the stage that the pilot Board went live. The total due up to the same stage under the original agreement was £600,000.

4.14 As the Accounting Service rolled out at the remaining four Boards, the Project Board continued to make payments based on the amounts being negotiated. By the time CCN 6 was signed in April 2000, the Contractor had received a total of £2,136,667, as opposed to £1,721,667 due under the original agreement. A difference of £415,000. The Project Board told us that payments were withheld from the contractor at various stages, until agreement was reached. The first invoices were received in December 1999 and were not paid in full until 30th March 2000, after CCN 6 had been agreed and only 5 days before it was formally signed off.

4.15 It is good practice that payment is not due or justified unless and until services have been received from a contractor. While the contract allowed part payment of any disputed invoice, we found no evidence to suggest that the Board had considered paying a reduced amount because the full Accounting Service was not initially available. It would appear that the Project Board was only contractually bound to pay a maximum of £600,000 following the service trial of the system. In the event, as a result of the CCN 6 Agreement, the Contractor was paid £800,000 in respect of accounting services up to the stage that the pilot Board went live. The Project Manager assured us that the Project Board had sought legal advice as to whether it should pay amounts other than those contained in the original contract but we found no documentary evidence of this advice.

Quality of Services Mechanisms

4.16 Services have to be delivered to the standard specified in a PFI Agreement if the contractor is to receive full payment of annual charges. The payment mechanism puts into financial effect the allocation of risk and responsibility between a public sector body and the contractor. It determines the payments the body will make to the contractor and the incentives for the contractor to deliver the service required. It is established best practice, as recognised in Treasury guidance issued in 1999 on standard contract terms (see footnote 5 paragraph 1.9), that PFI contracts should clearly set out required service standards, the performance measurement system and associated performance deduction system, and performance review processes.

4.17 The Agreement established the quality of service required in the development and operation of a new IT system to support the financial management information requirements of the Boards. It also included a methodology for measuring performance based on specific threshold levels associated with the availability of that system.

4.18 The Agreement also details how performance is to be measured against these thresholds and the effect that different levels of actual performance against the performance thresholds will have on the contract price. Under the Agreement, the Contractor will receive payments based on service thresholds being reached while service credits will be applied in the event of the contractor's failure to meet the thresholds. In addition, the Agreement provides for performance incentives.

4.19 Although the Agreement clearly defined performance levels with associated information requirements for judging performance, it did not address specifically the issue of how payments should be adjusted when the service is available but specific elements are not meeting the business requirements. The contractor took the view that if it was possible to access the service at all, then the availability criteria in the Agreement were being met. The Project Board, on the other hand, regarded the service as being unavailable if any element was not functioning at maximum level.

4.20 In the absence of an agreed definition of availability, we found that the "payment for performance" mechanism did not function as intended. In particular, the Contractor did not support the invoices it issued to the Project Board with the performance reports necessary to determine and validate contract performance. We found that statistical reports produced by the Contractor on service availability did not provide any supporting information setting out in an auditable manner how the figures had been calculated. Without a sound reporting framework, ensuring the accuracy of invoices for services provided became more a matter of judgement by the Project Board than an automatic means of holding the Contractor accountable for its performance.

4.21 As part of CCN 17 the Contractor and the Project Board reached an agreement on the concept of service availability. However, in our view, disputes over service availability and performance reporting could have been avoided earlier had the Contractor met a specific requirement of the Agreement. This was that a Service Code of Practice should be produced within six weeks of the execution of the Agreement.

4.22 The Service Code of Practice was to set out in detail the interfaces and procedures to be used by the parties for the day-to-day running of the project. We are concerned that, because the Service Code of Practice has not been produced, inaccurate reporting of performance may have resulted with the risk that potential non-performance by the Contractor may not have been determined correctly. The Project Board told us that the Service Code of Practice has been used as a working document and that it would be formally signed-off when it had been updated to reflect the detail of CCN17.

4.23 Under the Agreement payments to the Contractor are based on the level of performance it provides. As a result, accurate and transparent reporting is critical to ensuring that the Project Board receives value for the money it spends on the implementation and operation of the new accounting system. In view of this, NIAO recommends that the Project Board should ensure that, as a matter of urgency, it obtains agreement with the Contractor on the final version of the Service Code of Practice, formally documenting the reporting mechanism which the Department told us is already in place.

Anticipated Savings

4.24 We were told by the South-Eastern Board that the decision to proceed with the PFI solution was influenced by projected staff, maintenance and software licence savings of almost £6 million over the course of the original contract period. Over £3.5 million of the anticipated benefits related to the reduction of some 15 staff across the Information Systems departments of the Boards. The Gateway Review (see paragraph 3.20) "has identified that these anticipated savings have been realised as a result of a range of tasks for the old accounting systems, previously being undertaken by Board staff, now being the responsibility of the service provider ." However, the Review also points out that staff did not transfer to the Contractor, as originally planned. Rather, according to the review, "all the resources released have been deployed to other necessary IT related work within the Boards."

4.25 The anticipated annual savings which were associated with the payroll element of the project have not been realised to date, although some of these are counterbalanced by the reduction in payments to the contractor. The Gateway Review states that "as the new payroll service would have been more expensive than the existing system, there has been a compensatory benefit from the continuation of existing services which partially offsets the delayed benefits anticipated from the new payroll system." With regard to the deferral benefits, the Department told us that the Boards have effected savings in their Headquarters services because the funding provided by the Department for the project was net of projected annual savings and Headquarters budgets were reduced to reflect this. The Department also stated that the resultant reduction in Headquarters funding has not had a detrimental effect on the provision of other Board services as the improved information provided by the new system has enabled more effective decisions to be made across service areas.

4.26 We acknowledge the Department's comments on the reduction in Headquarters expenditure and note their claim that this was done without having a detrimental effect on the provision of Board services. However, it is important to realise that what has happened in this case is that an element of the annual efficiency savings which were originally anticipated have had to be offset against this project instead of being available for service provision in other areas.

4.27 The business case identified specific efficiency savings to justify the PFI deal. It is worth emphasising that this is an important feature of PFI projects and there needs to be a clear methodology to monitor those savings and demonstrate whether or not they are achieved.

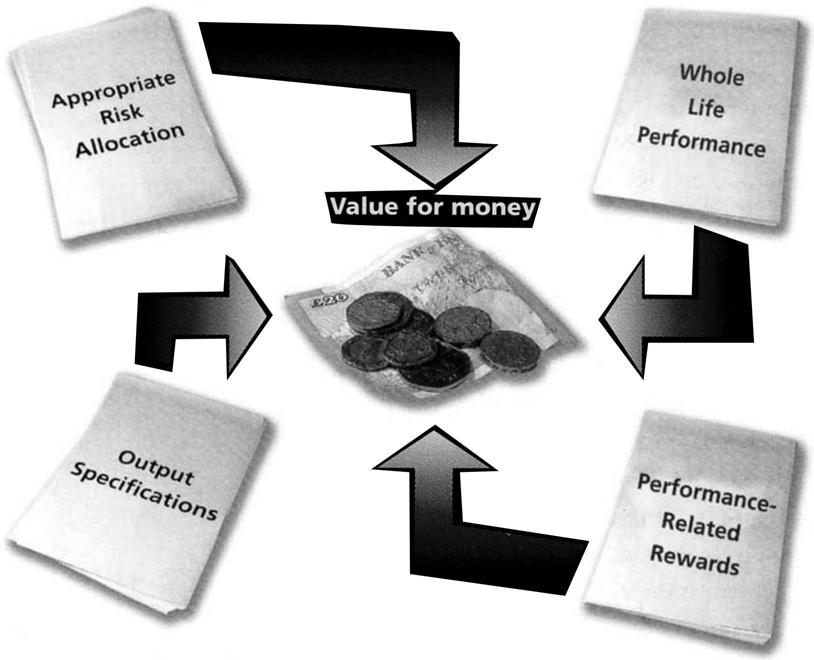
Current Position

4.28 The failure to deliver key modules contained in the original Agreement has had a significant impact on the timetable of the Project. It was envisaged that the PFI Agreement would be signed in January 1998; however this did not take place until January 1999. All the modules were to be fully operational by January 2001, but due to the difficulties described in Part 3 neither the payroll nor fixed assets modules could support the production of the Boards' accounts for 1999-2000: for the former the Boards had to continue to operate their existing payroll system and for fixed assets they had to resort to the use of manually prepared data. In order to make the system operationally compliant with the original tender specification, a lead Board is currently taking forward the issue of an improved payroll system, while new software is expected to meet the requirements for fixed asset accounting.

4.29 While the accruals accounting system is now operational, in February 2002 the final service trial across all the Boards did not meet all of the requirements. Final payment to the contractor has been withheld by the Project Board. **The Department told us that the Final Service Trial was repeated on 27th June 2002 when the performance of the system met the agreed criteria. The Project Board then approved the release of the Final Service Trial stage payment.**

Appendices

All PFI contracts share fundamental features that contribute to the delivery of value for money.



Source: Audit Commission

Appropriate risk allocation

- risks, such as demand, construction and financial risk, should be allocated to the party best able to manage them;

Whole life performance

- there is an understanding that the commitment of the private sector should be long-term;

Performance-related rewards

- contract mechanisms should provide for commissioning bodies to make payments to providers that are based on results; and

Output specifications

- commissioning bodies should concentrate on specifying the outputs expected from a contract, not on how these outputs should be delivered.

Northern Ireland Department of Finance and Personnel Memorandum Dated 30 September 1993 on 50th Report from the Committee of Public Accounts

PAC Conclusion	Department Response
On Strategy Formulation	
We consider that the establishment of a central Steering Group to develop a common strategy and the concept of using a lead Board for development purposes represent good practice. We recommend that, where appropriate, this approach should be adopted for the development of other major IT systems.	DENI welcomes the endorsement of good practice by the Boards and accepts the recommendation. The new Information Strategy for the NI Education Service will incorporate this approach, where appropriate.
Where Consultancy support is obtained on future projects, we recommend that the Department should ensure that there is adequate independent expertise available to assess effectively the advice and recommendations given by external consultants.	DENI accepts this recommendation. The current use now being made of the PRINCE project management methodology in all projects, and the Quality Assurance procedures contained within PRINCE, will ensure that such independent expertise will be available.
We welcome the Department's commitment that the development of the new five-year information system strategy will reflect lessons learned from the C&AG's examination and report.	No comment is necessary.
On Procurement	
We believe that many of the difficulties experienced by the Steering Group with the priority financial systems, could have been avoided if the advice and guidance available from the Central Computer Telecommunications Agency (CCTA) had been taken at the outset. We are pleased to note that for all new projects started since 1989 the CCTA methodology on procurement has been followed.	DENI notes these points.
We consider that greater care should have been taken by the Steering Group in agreeing short and medium-term hardware capacity requirements, thereby avoiding the piecemeal and probably more expensive approach to upgrading which took place over a relatively short period of time.	Notwithstanding the inherent difficulty in accurately projecting future needs, DENI accepts the point and is satisfied that current procedures and practices now in place should minimise such problems in the future.
We consider that, where there are particular potential risks, such as those associated with integrating separate packages, project managers must complete a very thorough evaluation of suppliers' assurances.	DENI accepts this point and is satisfied that any such future evaluation will be rigorous, and in accordance with the relevant CCTA methodologies.

We note that there is still a limited level of management information available to Boards and consider that action should be taken to address this shortcoming.

While the availability of management information has improved, DENI accepts that more remains to be done in this area. The current review of Information Systems strategy specifically addresses this matter and improvements in MIS are planned subject to availability of resources.

On Project Control

We remind all Accounting Officers that for any project or programme, there must from the outset be a clear statement of objectives and the establishment of effective project management, so that corrective action, as necessary, can be taken during the currency of the project or programme. At the completion of the task there should also be a clear statement of what was actually achieved as compared with the original objectives.

DENI is satisfied that procedures and practices now in place will ensure more effective project initiation, management and evaluation.

We recommend that, for all future projects in Great Britain as well as Northern Ireland full use should be made of CCTA's advice and support to ensure that contracts with suppliers are effectively managed and controlled, and that if the CCTA's advice is not followed the reasons should be recorded in writing.

The Treasury issued guidance on the role of CCTA in June 1992. This required Departments to follow CCTA guidance on project management and related issues. It is good project management practice to record all decisions in writing. DENI has now put in place a Customer Service agreement with CCTA services by all bodies in the Education Service.

We are concerned that the premature mobilisation of implementation teams for the payroll and Personnel System may have resulted in unnecessary expenditure.

DENI notes this point and can confirm that this specific matter is being addressed as part of the current legal action between the Education and Library Boards and the relevant computer supplier.

On Post-Implementation Evaluation

We are concerned that post-implementation evaluations were not pursued more vigorously. Such evaluations are very important in learning lessons and therefore we recommend that DENI should ensure that all current and future projects will be subject to timely and full evaluations.

DENI accepts this point and has advised the Boards and other NDPBs accordingly. DENI is satisfied that procedures are now in place to ensure that post-implementation evaluation of all current and future projects will be completed in a full and timely fashion. Work is currently nearing completion to conclude all outstanding evaluations.

On the Use of Consultants

We are seriously concerned at the lack of competitive tendering for consultancy support which resulted in the Steering Group not being able to demonstrate that the cost of such support represented value for money. We recommend that DENI should ensure that its revised guidance to Boards provides for future consultancy support to be subject to competitive tendering and that circumstances in which a consultancy contract is awarded, without recourse to competitive tendering, are clearly defined.	DENI accepts the recommendations and has already acted to ensure that the Boards have been issued with the most up-to-date guidance from CCTA and DFP on this subject.
We consider that the Department should ensure that the maximum use is made of in-house resources and future consultancy assignments should be subject to clear and precise terms of reference.	DENI has acted to ensure that guidance on these matters have been issued to Boards. In addition the current development of a new Information Systems strategy for the NI Education Service addresses the means by which the most effective and efficient use of in-house IT resources can be deployed for the future.
We are concerned at the failure to monitor the performance of consultants but welcome the setting up of an external review, which is scheduled for completion by June 1993. We recommend that DENI should incorporate any lessons learned into its existing guidance and ensure that effective arrangements are established for monitoring consultants.	DENI accepts this recommendation and can confirm that the review in question has now been completed and the recommendations contained in the report of this review have been fully accepted and adopted by the Boards' IT Steering Group.

Role of the Department of Education

We welcome the Department's assurance that it has significantly improved its monitoring arrangements of Boards' computer developments. Once again we state that it is of fundamental importance that all departments should monitor effectively the activities of the non-departmental public bodies which they fund and for which they are responsible.	Treasury guidance on information technology projects issued in June 1992 requires Departments to ensure that NDPBs comply with appropriate CCTA guidance. The Treasury and Cabinet Office have also issued general guidance to Departments monitoring their NDPBs. DENI introduced improved financial monitoring arrangements over 12 months ago. This requires the Boards to provide to the Department monthly monitoring returns on earmarked expenditure and is soon to be supplemented by the first comprehensive report on IT in the Boards, which in future will be produced annually.

14 Stage Guide to PFI Procurement

1. Establish business need:

It is vitally important that the project is used to address pressing business needs. If the status quo - with incremental rather than substantial change - appears a reasonable option, both public and private commitment to completion of the project, regardless of procurement route, is likely to be limited.

2. Appraise the options:

This involves identifying and assessing realistic alternative ways of achieving the business needs. The potential scope of the project needs to be understood and, in particular, viewed within the context of what services need to be procured. Relevant budget constraints (affordability) should always be borne in mind.

3. Outline business case:

Where PFI is the most suitable method of procurement, an outline business case needs to be prepared, establishing that the project is affordable under the PFI approach. This includes the development of a "Reference Project" (or scheme profile) which provides a fully costed combination of capital investment, operations, maintenance and ancillary services, including a quantification of key risks. Some market sounding may be appropriate at this stage. For significant projects, DFP will also become involved at this stage.

4. Creating the project team:

With the output specification and the outline business case in place (and DFP approval where appropriate), the formal procurement process can be set in motion. The first step is to form the procurement team. It is important that the negotiation skills and PFI competence of the team are able to match the professional skills anticipated of the bidding consortia. It may be appropriate to seek external skills and experience from competent advisers.

5. Publication of OJEC notice:

The formal invitation of expressions of interest from the private sector begins with the publication of a contract notice in the Official Journal of the European Community (OJEC). The advertisement should explicitly mention PFI and include sufficient explanation of the project to attract any relevant supplier. The Negotiated Procedure with a "call for competition" is normally appropriate, providing flexibility for the client. Parties then expressing an interest in the project should be provided with a more detailed "Information Memorandum" setting out the project scope, specification, funding and selection criteria.

6. Deciding tactics:

By the time of issuing the Information Memorandum, the public sector procurement team should have formed a view on tactics; in particular, the selection process. A key decision is whether or not to eventually select a Preferred Bidder. If a Preferred Bidder is to be chosen, as is the case in most PFI contracts, it is generally good practice to do this only after obtaining priced bids which have been informed by a full discussion of commercial terms and a written declaration by the bidder of those terms which are acceptable and those which he still seeks to negotiate. However, because of the onerous nature (in time, resource and money) of working up a full bid, the final tender list should(by Stage 8) be limited to 3-4 candidates.

7. Prequalification of bidders:

The list of respondents to the OJEC notice needs to be reduced to a long list (or immediate short list if the project is straightforward). Tests such as general technical competence, experience or financial strength should be applied.

8. Shortlisting:

Whereas prequalification is a test of general competence, selection for the final shortlist must be on the grounds of specific project competence. To select the tenderers, it is legitimate to request, in some technical detail, the approach bidders would take to the project, including their appetite for risk, financing and indicative price. Confidentiality of bidders' proposals is paramount.

9. Revisit and refine the original appraisal:

Before the detailed bids are formally requested through the Invitation to Negotiate (ITN) stage, the original appraisal of the project needs to be re-visited. Drawing on knowledge gained during the procurement process to date, it is likely that some refinement of the output specification, business case and reference project (PSC) will be needed.

10. Invitation to Negotiate:

The ITN should be specific as to:

- the services required, in output terms;
- the constraints on the scope of the project;
- proposed contractual terms (length, payment method);
- the evaluation criteria for bids;
- the scope for variant bids.

This stage may be quite lengthy for complex projects - perhaps three to four months. There is a lot of material for bidders to absorb and then respond to in a formal bid.

11. Negotiation with bidders:

Parallel discussions are now required with each bidder, initially to clarify each proposal and assess whether they meet the output requirements. Further negotiations should be aimed at pinning down the commercial terms of the contract, and ensuring that the contracted outputs will be delivered. By making the best use of competition the draft contract should be agreed as much as possible while there is more than one bidder. At the end of this stage, each bidder may be asked to submit a "best and final offer" (BAFO), on the basis of the clarified bids.

12. Selection of preferred bidder and negotiation to financial close:

From the BAFOs received, the Preferred Bidder can then be chosen. Again, the PFI proposition should be tested against the key risk transfer, value for money and affordability criteria. The final negotiations should be taken up with fixing the final detail of the transaction and satisfying the reasonable requirements of the project funders. To maintain discipline, the second-placed bidder should be requested to keep an offer on the table.

13. Award Contract:

When the contract is signed, a contract award notice is placed in the OJEC.

14. Contract Management:

The management of the contract is a distinct process which follows on from the process of procurement. While some degree of continuity is important, new processes will be needed. The structure of the contract will have defined the basis for the new, long term operational and managerial relationship between public sector client and PFI service provider.

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