

North Tyneside Council

Report to Council

Date: 27 September 2012

ITEM 8

Title: Risks of Outsourcing

Portfolio(s): Elected Mayor
Finance
Community and Regulatory Services

Cabinet Member(s): Mrs Linda Arkley
Judith Wallace
George Westwater

Report from Directorate: Finance and Resources

Report Author: Fiona Rooney (Tel: (643 5724))
Strategic Director Finance & Resources

Wards affected: All

PART 1

1.1 Purpose:

At its meeting on 13 August 2012 Cabinet approved the recommendations to appoint preferred bidders for the Business and Technical packages of services. Cabinet also noted the Council motion of 26 July 2012 that sought an opportunity for Council to consider and debate an analysis of the risks of outsourcing at its meeting on 27 September 2012.

The purpose of this report is to:

- (a) Set out the risks of any outsourcing;
- (b) Set out the risk management approach to the procurement and implementation of the Business and Technical packages of services; and
- (c) Set out the main contracting terms that aim to control the risks.

1.2 Recommendation:

It is recommended that Council:

- (1) Note the risks of outsourcing set out in the report;
- (2) Note the approach taken to risk management during procurement of the packages and the planned approach to managing ongoing risk.

1.3 Forward Plan:

This item does not appear on the current forward plan but needs to be considered at this meeting of Council pursuant with the Council motion of 26 July 2012.

1.4 Council Plan and Policy Framework

This report relates to the 2012-2015 Council Strategic Plan and the Change, Efficiency & Improvement Programme as part of the 2012/13 Budget Envelope.

1.5 Information:

1.5.1 Background

1.5.2 At its meeting on 13 August 2012, Cabinet agreed to appoint preferred bidders for the Business and Technical packages of services. Cabinet also noted the Council motion of 26 July 2012 and requested that a report on the risks of outsourcing be submitted to the Council meeting on 27 September 2012. This report sets out the risks of outsourcing.

1.5.3 The risks of outsourcing

1.5.4 The risks of outsourcing generally are set out in the independent Yougov research paper appended to this report. There are other research papers available in the public domain but these largely relate to the risks of Public-Private Partnerships and service sharing arrangements.

1.5.5 The appended report sets out how well local authorities are positioned to meet the 2014 budgetary challenge, and how they perceive outsourcing and partnerships can support them to achieve this. A similar report was published last year (Local Services: Better for Less) and is available at the office of the author.

1.5.6 Balancing the benefits and risks of outsourcing

1.5.7 It is important to balance the risks of outsourcing with the benefits sought from it. For the Council's Business and Technical Partnerships, these are captured in the objectives set by Cabinet on 14 November 2011 which are:-

- a) Investment in the services affected by the Project;
- b) Job protection for the existing workforce;
- c) Growth opportunities for the services in a wider marketplace leading to the creation of additional jobs within the Borough;
- d) Financial efficiencies of at least £4.9 million within the first three years of the partnerships (£2.2 million from the Business Package and £2.7 million from the Technical Package) and ongoing efficiencies thereafter subject to future financial pressures;
- e) Efficiencies in relation to the Council's use of office accommodation by the co-location of a partner provider within the Borough; and,
- f) Improved performance of the services.

1.5.8 The approach taken to risk management for the packages

1.5.9 A Procurement Risk Management Plan has been implemented throughout the delivery of the Project. This has been maintained by the Project Team and reported through the governance arrangements of the Change Efficiency and Improvement (CEI) Programme via the Theme B Board.

1.5.10 The Business and Technical packages are not the first partnerships the Council has entered into. The Project Team has taken care to learn from these previous experiences as well as other partnerships around the country; replicating approaches that have worked well, and improving or changing those that did not work so well. At the start of the process, officers and members visited some of these partnerships to learn about their approaches.

1.5.11 The procurement process is nearing completion and the Alcatel or standstill period has now expired. The Council will now develop an Implementation Risk Management Plan with each preferred bidder that reflects the solutions offered in their bids. These plans will be used to manage ongoing operational risks.

1.5.12 Checks and balances within the partnership contractual arrangements

1.5.13 The main contracting terms that protect the Council are set out in the Cabinet Report of 13 August 2012. To assist Members in the debate about risk, these are summarised below:-

1. Term – the contract is for a term of 10 years, the Council will be automatically obliged to extend the contracts by a further 5 years should the Partners continue to provide value for money, meet the Collective Partnership Targets and there have been no significant key performance indicator failures or material defaults under the terms of the contract. A significant KPI failure would arise where three or more deductions occurred in the two years prior to the decision to extend the contract.
2. Monitoring – The Project team have established 3 levels of monitoring the partnership through Collective Partnership Targets, Key Performance Indicators and Performance Indicators.
 - a. The Collective Partnership Targets link to the partnership objectives agreed by Cabinet. Monitoring of these targets will be carried out on an annual basis to ensure the Partner is meeting their contractual obligations. Any failure of the Partner to deliver the Collective Partnership Targets in accordance with the contractual arrangements may be deemed a breach of contract on the part of the Partner and the Council may seek to rectify using the contractual remedies available. Remedies available to the Council will include removal of exclusivity to the Partner or at the extreme termination of the contract.
 - b. A suite of Key Performance Indicators (KPIs) have been agreed with bidders, the KPIs were developed utilising in-house information as to the current performance levels, national benchmarking and intelligence from other local authorities and reflect current national and local policy. Failure to achieve KPI's will attract a performance deduction.

- c. The Partners will also provide monitoring information against Performance Indicators (PIs) as agreed during the dialogue process. The PIs are based on existing monitoring arrangements to senior management.
 - d. Where the Council do not currently measure the KPI targets this will be subject to a baselining exercise. This will take place from contract commencement until 31 March 2013 to ensure that the targets imposed are robust.
 - e. As referred to above the KPIs reflect current local and national policy. Local policy will be determined by either the Cabinet or Council depending on where the functional responsibility lies, but at all times what is being delivered is a matter for the body with the functional responsibility to determine. How the service is delivered is a matter for the Partners as the KPIs are outcome based and do not determine the manner in which the service is delivered.
3. Review – an annual review will be undertaken by the Strategic Partnership Board to review performance of the contracts, agree the business plan for the following year, review KPIs and PIs and to ensure that the Partners are achieving the Collective Partnership Targets. This will ensure that the contractual targets remain relevant. A more robust review of the partnership will take place in year 5 of the contract, the primary aim will be to review the services which are being delivered under the contracts and review the Collective Partnership targets.
 4. Governance – the Partnerships shall be managed on a day to day basis by the Operational Partnership Boards. These will consist of Partner employees and also the retained client. These will be governed by the Strategic Partnership Boards and these will be responsible for setting and reviewing the strategic objectives and targets for the Partnerships. The Elected Mayor and appropriate Cabinet Member will be members of the Strategic Partnering Board. Scrutiny of the contract outcomes will continue to be available to be examined and challenged by the Council's overview and scrutiny arrangements. The Partnership Boards will also consider any new projects to be delivered by the partnerships and how these are managed through the change control procedure. A training needs analysis is underway for client retained staff to ensure that they have the skills to effectively manage these contracts.
 5. Commitments to local employment – the contract as drafted requires Bidders to submit solutions for meeting the Collective Partnership Targets, linked to the Councils key objectives of growth opportunities. Bidders solutions were to describe how many jobs would be created in the Borough and how this would be achieved.
 6. Staff – the Business Package provides that approximately 420 employees will transfer to the Partner. The Technical Package has approximately 335 employees. Further, the Technical Package has 58 full time equivalent employees who will remain in the employment of the Council, however, seconded to the successful Bidder to enable the Council to fulfil its statutory duties.
 7. Statutory Functions - the Council has a scheme of delegation in place delegating the Council's statutory functions to Council officers and this approach will continue. The Technical Package has the largest number of statutory functions, such as planning, licensing and environmental health, which officers discharge on

behalf of the Council. To preserve the delivery of these statutory functions, Bidders were asked to model on the secondment basis referred to above. If, at any point in the future, changes to the statutory framework occur it is possible that those officers will TUPE transfer to the successful Partner.

8. Pensions - it was a requirement that the Partner obtained Admitted Body Status in order to protect the employees pensions. An actuarial valuation was carried out and this proposed an increased rate to the employer's rate (of the successful Partner). The Bidders were requested to factor Pensions costs into their financial model. As a valuation of the employer's pensions contributions is made every 3 years this amount may vary over time. The Council requested that Bidders factor in a highest and lowest limit of +/-3% on the valuation sum. At the end of the contract there may be an exit liability on the Council and so Bidders were asked for their proposals as to how the exit liability could be managed. In addition, all Bidders were required to put in place a bond to cover any liabilities of the Partner that may arise as required by the Tyne and Wear Pension Fund.
9. Value for Money – the Council required the Partner to show value for money throughout the term of the contract, a benchmarking test against other providers will be undertaken in years 4, 8 and 12 of the contract. This is a robust mechanism to ensure that the contract price is still valid and comparable in a similar market place. The Council will request that a benchmarking test is undertaken at the identified points in the contract and also is required when the Partner undertakes a new project. This will give transparency as to overhead costs, rates and/or profit. A target range of costs will be provided, whether this be local or national targets for comparable services, and the Partner must always remain within this tolerance at the testing points. Failure to do so may result in the Council withdrawing exclusivity or terminating the contract.
10. Performance - a robust payment and performance mechanism will be in place. Each Workstream contains a number of Key Performance Indicators (KPIs) which set out the area to be measured, the Expected level of performance at which the full payment attached to that KPI will be passed to the Partner, and a Minimum level of performance, below which no payment will be made to the Partner. Of the total payment due to a Partner, an amount is classed as “at risk” on the basis of performance. All Bidders have accepted a value of 35% at risk, which is considered to be a good value with which to motivate levels of performance.
11. Supply Chain – the Council cannot currently procure local providers to deliver services as this is contrary to EU Treaty principles of transparency and openness. The Procurement rules only apply to Public Bodies therefore any private sector supplier can source its own supply chain which may in turn assist local businesses. Incorporating social issues such as supporting the local economy can only be used as evaluation criteria where they are directly linked to the subject of the contract. Social issues, such as job creation and protection, were incorporated as part of the contractual obligations with which the successful Partner must comply.
12. Buy Back – to ensure continuity of services there are a number of areas which the Business Package are to provide to the Technical Package, this includes ICT, financial support and HR functions. This support is to be provided to the Technical Partner until 31 March 2015. The Council is to be indemnified for any failure of the Business Partner. Bidders have also provided details of additional services which the Council may choose to provide to the successful Partner. The officer team's

assessment of overheads has taken into account findings from previous contractual negotiations. If buy back arrangements do not extend beyond the initial period, the Council will retain sufficient budgets to cover any remaining/fixed costs associated with those services. Officers are therefore confident that there will not be any “overhanging overhead” issues arising.

13. Licence – a licence over areas at Quadrant is agreed with Bidders. Further, the Bidders may in future seek to take additional space within Council buildings to maximise efficiencies.
14. Assets - which are used in delivery of the services will transfer to the Partner at the commencement of the contract for a nominal value. A record of assets used by the successful Partner will be maintained throughout the lifetime of the contract and returned at the end of the contract. In relation to the Technical Package it is envisaged 44 fleet vehicles will transfer to the Partner. Bidders were asked to provide a detailed refresh and renew programme in relation to the fleet.
15. Winter maintenance services - will transfer to the Partner however given the commencement date of the contract the Council will retain responsibility for the winter maintenance in 2012.
16. Termination – ultimately, termination of the contracts by the Council may occur in the following ways:-
 - a) Termination at will – the Council may terminate the Contract at will however this option can only be exercised after an initial period, this ranges from 3 to 5 years as proposed by the bidders. The actual cost of termination would depend on when in the term of the contract the Council seeks to exercise this option.
 - b) Termination for default - the Council may terminate the agreement should the Bidder fail to perform at any point during the contract. Performance deductions will be made prior to any contractual remedy applying. The Council may provide the Partner with an opportunity to remedy the default prior to termination. However if the Contractor has materially defaulted under the terms of the contract, the Council has the option to terminate the agreement without proceeding with such a default notice. The Partner will have exclusivity to provide the services detailed within the Business and Technical Packages, however any performance failure may mean that exclusivity is withdrawn and an alternative delivery model may be employed to ensure the services are continually delivered to a high standard. The successful Partner shall indemnify the Council for any increase in costs due to their failure to perform.
 - c) Termination on benchmarking. At year 8 a benchmarking test will be carried out, should the Partner prove not to provide value for money the Council shall not be obliged to extend the contract by a further 5 years. This will also be the case should the partner have failed to meet the Collective Partnership Targets, KPIs or if the Council has served a material default notice on the Partner.

1.5.14 Member workshop(s) to explain the contractual arrangements and the key performance indicators (KPIs) will be arranged as agreed by Cabinet on 13 August 2012 in response to the recommendations of Overview and Scrutiny Committee held on 6 August 2012.

1.6 Decision options:

1.6.1 Council is asked to note:-

- (1) The risks of outsourcing set out in the report;
- (2) The approach taken to risk management during procurement of the packages and the planned approach to managing ongoing risk.

1.6.2 Council could reject the recommendation.

1.7 Reasons for recommended option:

Council is asked to note the report in line with the request from Council on 26 July 2012.

1.8 Appendices:

Appendix 1 – Local Services: in need of transformational change, a report on outsourcing by Interserve and Yougov Research. Published 29 July 2012.

1.9 Contact officers:

Katy Middleton, Corporate Manager (Commercial Team), tel. 643 5854
Sarah Heslop, Manager Commercial Team (Legal Services), tel. 643 5456
Vicki Dixon, Senior Manager (Financial Strategy and Planning), tel. 643 5723

1.10 Background information:

The following background papers have been used in the compilation of this report and are available at the office of the author:

- (1) Delivering Change, Efficiency and Improvement: A four year plan, Cabinet 7 March 2011.
- (2) Change, Efficiency and Improvement Programme, Cabinet 12 September 2011.
- (3) Change Efficiency & Improvement (CEI) Programme – Procurement of Business and Technical Services, Cabinet report dated 14 November 2011.
- (4) Change Efficiency and Improvement Programme Business and Technical Package Procurement – selection of Preferred Bidders, Cabinet report dated 13 August 2012.
- (5) Local Services: Better for Less, a report on outsourcing by Interserve and Yougov Research. Published 30 June 2011.

PART 2 – COMPLIANCE WITH PRINCIPLES OF DECISION MAKING

2.1 Finance and other resources

There are no direct financial implications of the recommended option.

2.2 Legal

There are no direct legal implications of the recommended option.

2.3 Consultation/community engagement

2.3.1 Internal Consultation

The project's approach to risk has been managed by the Project Team and the Project Sponsors. The Risk Log has also been reported to the Change Efficiency and Improvement (CEI) Theme B Board during the procurement process.

2.3.2 External Consultation/Engagement

No external consultation or engagement has been undertaken in relation to the compilation of this report.

2.4 Human rights

There are no direct implications of the recommended option under the Human Rights Act 1998.

2.5 Equalities and diversity

There are no direct implications of the recommended option in respect of equalities or diversity.

2.6 Risk management

There are no direct risk implications of the recommended option.

2.7 Crime and disorder

There are no direct implications of the recommended option in respect of crime and disorder.

2.8 Environment and sustainability

There are no direct implications of the recommended option in respect of environment and sustainability.

PART 3 - SIGN OFF

- Chief Executive X
- Strategic Director(s) X
- Mayor/Cabinet Member(s) X
- Chief Finance Officer X
- Monitoring Officer X
- Strategic Manager, Policy and Partnerships X