



National Audit Office

A Framework for evaluating the implementation of Private Finance Initiative projects: Volume 2

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A Framework for evaluating the implementation of Private Finance Initiative projects: Volume 2

This volume has been published alongside a first volume –
A Framework for evaluating the implementation of Private Finance Initiative projects: Volume 1

This document has been prepared by the National Audit Office as part of its Good Governance programme. Good Governance projects aim to draw on the NAO's cross-governmental experience and independent perspective to help organisations delivering public services achieve excellence in financial management, operational efficiency and quality of service.

In particular, Good Governance projects aim to:

- Promote improved management of risks to the effective delivery of public services and stewardship of resources;
- Focus on issues that, in the judgement of the client organisation, are timely, relevant and important;
- Contribute to the delivery of efficiency savings, and, where possible, direct financial impacts; and
- Bring a wider perspective to the client organisation's practice by drawing on the NAO's knowledge of financial management and service delivery issues across government.

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This report can be found on the National Audit Office web site at www.nao.org.uk

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PART ONE

Introduction: Making use of the matrix: the detailed audit criteria

This volume provides a phase-by-phase guide to using the matrix for evaluating PFI projects at each main point in their life-cycle.

1.1 Each of the six sections in this volume addresses one life-cycle stage, setting out the indicators expressed in terms of questions that can be answered either yes or no. This is not to suggest that the answers to the questions will be as simple as this in practice; the reality is likely to be far more complex. The purpose of posing yes/no questions is to provide a straightforward framework to aid those considering whether their PFI project is well structured.

1.2 Throughout this volume, the term “evaluator” refers to those conducting a review of the implementation of a PFI project, whether within the project team or outside it. The term “the Authority” is used to describe the public sector body responsible for procuring the PFI project, in central or local government, or in an Executive Agency, as relevant.

1.3 Each section of volume 2 is structured as a detailed analysis of the six business-management themes applying to the particular life-cycle phase of the project in question. This analysis focuses on highlighting the key issues that an evaluator should consider when determining whether the indicators for a theme have been met. Annex 1 provides a more detailed analysis of the questions to be asked at each phase, with references to other government publications concerned with implementing PFI well.

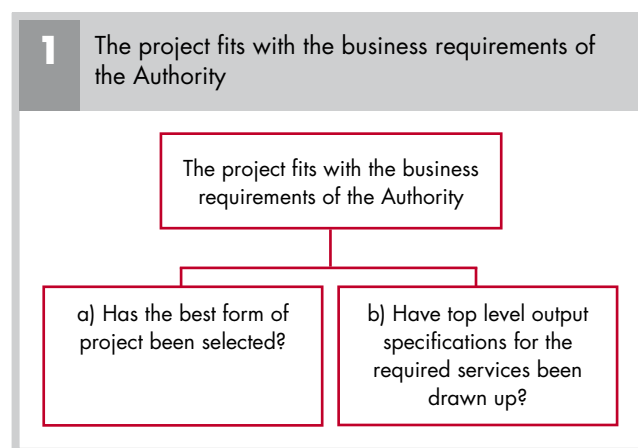
PART TWO

Strategic analysis

2.1 In this phase, analogous to Stage 1 and Stage 2 of the 2004 Treasury VFM Guidance, the assessment by the evaluator focuses on whether the Authority has produced a clear case for proceeding with the chosen investment. It then considers whether seeking a PFI solution was the best procurement approach¹.

The project fits with the business requirements of the Authority

2.2 As part of its strategic planning process, the Authority should establish a clear need for the services being procured through the project. Such an assessment by the Authority should form the basis of the investment decision to proceed with the project. In addition, the Authority should also have started drawing up the specifications for the required services in order to facilitate the analysis of the appropriate procurement approach. The evaluator should therefore seek assurance that the Authority has addressed both these issues (see **Figure 1**).



¹ HM Treasury's *Value for Money Assessment Guidance* (August 2004) sets out an overview of the approach to appraising the value for money of investment proposals to be procured under the Private Finance Initiative.

a) Has the best form of project been selected?

2.3 The chosen project should reflect the outcome of an investment appraisal that justifies the need to procure the relevant services to be delivered through the project. Key questions that the evaluator should consider include:

- Have clear objectives for the project been set?
- Does the project meet policy imperatives?
- Was the project assessed as being priority?
- Has a preliminary evaluation of the benefits sought been made?
- Has long term commitment to the project been demonstrated?
- Are the project outcomes clear?
- Have the project’s wider socio-economic benefits been quantified?
- Does the proposed solution clearly meet business requirements?

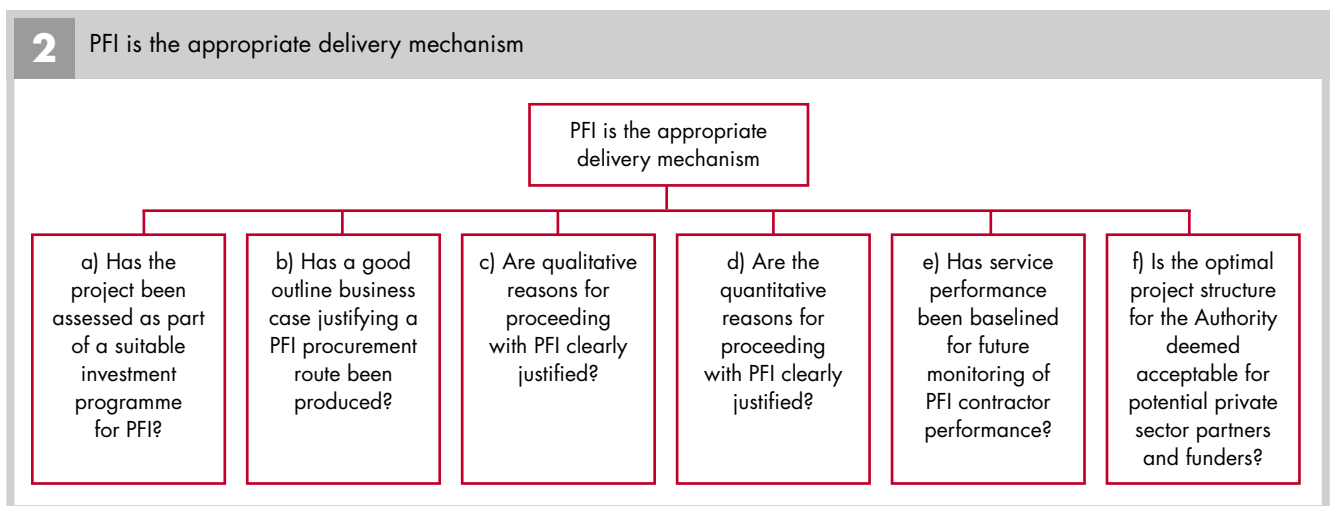
2.4 The evaluator should seek sufficient evidence that the above questions have been fully dealt with in the investment appraisal. Key guidance for authorities on these issues is contained within HM Treasury’s *Green Book*².

b) Have top level output specifications for the required services been drawn up?

2.5 It is helpful at this stage of a project for the Authority to have drawn up the project’s top level output specifications and to have sketched out the proposed performance measurement (PMS) and payment mechanism systems. These need to be completed prior to going to tender as a basis for getting good value for money (see paragraphs 3.2-3.9 for greater detail on evaluating output specifications, PMSs and payment mechanisms) and it is helpful to have completed as much work as possible prior to production of an outline business case. Doing this will facilitate the analysis of whether PFI is the appropriate option for procuring the project.

PFI is the appropriate delivery mechanism

2.6 Having assessed the validity of the project investment proposal, the Authority should identify the most suitable procurement route for it. This issue is reflected in four of the indicators noted at **Figure 2**. The first few indicators comprise a check on the suitability of a PFI procurement route. Of the last two indicators, one addresses the baselining of current service performance to facilitate future assessment of performance under a PFI contract and the other indicator addresses whether the desired project structure is acceptable to potential private sector providers.



² HM Treasury: *The Green Book: Appraisal and Evaluation in Central Government* (2003).

a) Has the project been assessed as part of a suitable investment programme for PFI?

2.7 Under guidance issued by the Treasury in 2004 it *'is expected that, as a minimum, all departmental PFI projects will have been assessed at programme level prior to the Procuring Authority embarking on the completion of an Outline Business Case'*³. The evaluator should confirm that this evaluation has taken place in line with the qualitative and quantitative analysis required by the Treasury Guidance. These two types of analysis should bear in mind the indicators d) and e) below. The evaluator should also determine whether the Authority has made use of the OGC Gateway Process which provides the opportunity for an assessment of an investment programme and its potential to succeed⁴. The evaluator should seek evidence that the Authority has responded to any concerns raised in the OGC assessment.

b) Has a good outline business case justifying a PFI procurement route been produced?

2.8 Stage 2 of the Treasury 2004 guidance requires a project level assessment which is designed *'to ensure that value for money is achieved by testing the programme level assumption that PFI is the most appropriate procurement route in light of the specific characteristics of individual projects.'*⁵

2.9 An outline business case should be produced as part of this process, making a sufficient case in both qualitative and quantitative terms to justify selecting a PFI procurement option over alternatives. The evaluator should seek assurance that the optimal project structure reflects both of these types of analysis. As with the programme assessment, the evaluator should also determine whether an OGC Gateway review has taken place on the outline business case and that the Authority has responded to any concerns raised by the review⁶.

c) Are qualitative reasons for proceeding with PFI clearly justified?

2.10 The business case should demonstrate that a viable PFI contract can be constructed. The evaluator must examine whether the Authority has confirmed the following in its analysis⁷:

- Whether a PFI contract can deliver the objectives and outputs of the Authority's Investment Programme Level Assessment⁸.
- Whether a PFI contract offers the Authority sufficient operational flexibility. Changing a long-term contract can be time consuming and costly and a long term contract may not be appropriate if the nature of service provision is likely to change considerably.
- Whether there are no overriding reasons for providing the service directly by the Authority.
- Whether the private sector is capable of delivering the required outcome. Reasons why this might not be the case include:
 - lack of technical knowledge; or
 - financial structures that are unable to cope with downsized delivery without further public support.

2.11 The business case must show that PFI can bring additional benefits over alternative procurement routes. The evaluator must in particular review the value for money case the Authority has made in addressing the following:

- Whether there is significant scope for the cost effective transfer of risk to a private sector partner.
- Whether there is likely to be scope for innovation in the design and construction of the asset or in the delivery of associated services if delivered under PFI.
- Whether the transfer of service provision covered by a PFI contract is essential for improved delivery.
- Whether the potential PFI services can be assessed against an agreed and objective standard, i.e. the outputs can be measured objectively.
- Whether the PFI payment mechanism will incentivise the contractor to provide the levels of service required.
- Whether the services are suitable to be managed on the basis of a long term contractual relationship.
- Whether it is possible to integrate the design, build and operation of the project. By integrating the life-cycle and operation costs with the design and construction, there may be opportunities for better risk management and incentives to develop innovative approaches to output delivery.

³ HM Treasury *Value for Money Assessment Guidance* (August 2004), p. 13.

⁴ OGC: *Gateway Review 0: Strategic assessment*.

⁵ HM Treasury: *Value for Money Assessment Guidance* (August 2004), p. 17.

⁶ OGC: *Gateway Review 1: Business Justification*.

⁷ The issues raised in this section and the subsequent section on quantitative analysis draw heavily upon the guidance in HM Treasury's *Value for Money Assessment Guidance* (August 2004).

⁸ Stage 1 of HM Treasury's *Value for Money Assessment Guidance* (August 2004), pp. 13-16.

2.12 Finally, it is important that the business case demonstrates that PFI procurement is achievable. The evaluator should review whether:

- The Authority has assessed its capability to manage the project and appraise ongoing performance against agreed outputs.
- There is sufficient market appetite for the project.

2.13 Evidence is not clear cut on whether soft services procured under PFI are significantly better than those procured through other routes and therefore when considering the potential structure of a project to be procured through PFI, the Authority should bear careful consideration as to whether soft services merit inclusion⁹. Similarly, the Authority should justify the length of the PFI contract it proposes for the project, ensuring that the length of the contract is appropriate to the nature of the services and assets being provided¹⁰.

d) Are the quantitative reasons for proceeding with PFI clearly justified?

2.14 A strong quantitative case that PFI offers the best value for money must be made. Key questions which the evaluator must consider in assessing the validity of the case include:

- Is there a comparison between the likely costs of the PFI option and the likely cost to the Authority of proceeding with a non-PFI procurement solution, i.e. the Public Sector Comparator (PSC)?¹¹
- Are assumptions based on sound experience from all types of relevant past procurement experience? It is important that values attached to risk assessment reflect the most recent research on cost overruns.
- Is the overall project affordable? The Authority should have established cost limits for the services it proposes to procure. The evaluator should check that the Authority has identified long term funding streams that would cover these costs. There is a possible conflict between what is assessed as value for money and affordability. The Authority must be clear about where it stands on this issue, which requires an analysis of the trade-offs between cost and service outputs, and which are most valued if not all can be afforded.

- Have the benefits of different central case options, both PFI and non-PFI, been quantified as well as the relevant costs?
- Has sensitivity analysis been undertaken to compute the effect of assumptions on the relative value for money of the different procurement options? For example, the cost implications of changes in the service volumes required should be calculated for different options. Small differences in the cost of options are not likely to be meaningful in themselves, and decisions should take all factors into account.
- Have the transaction (i.e. procurement and then subsequent project) costs such as advisors fees, for the different options been assessed as reasonable?

2.15 One of the potential advantages of using PFI is that it incentivises contractors to deliver the required service over the whole life cycle of the asset, i.e. the private sector gets paid to maintain standards throughout the length of a contract¹². It is therefore important that the evaluator is reassured by the assumptions made about lifecycle costs and the robustness of the Authority's life-cycle modelling techniques.

e) Has service performance been baselined for future monitoring of PFI contractor performance?

2.16 It is important that the Authority should baseline service provision at the Strategic Analysis stage, to facilitate future realistic assessment of PFI contractor performance. Baselining involves an assessment of the current service provision performance (whether provided in-house or contracted out) from the old asset. This will provide the Authority with clear comparative data for assessing the PFI contractor's service performance once the contract becomes operational.

2.17 The evaluator should confirm that the Authority has carried out a baselining exercise. The ideal scenario would be for the Authority to apply to current performance levels to the performance measurement regime it is proposing for the contract.

⁹ HM Treasury: *PFI Strengthening Long Term Partnerships*, (2006) p 86. HM Treasury is planning to publish strengthened guidance on assessing the value for money of including soft services within a PFI contract.

¹⁰ HM Treasury: *PFI Strengthening Long Term Partnerships*, (2006) p 8. The Government is proposing to introduce sector specific concession length caps.

¹¹ Guidance on producing this comparison at outline business case stage is contained within the *Quantitative Assessment User Guide* accompanying the Treasury's 2004 *Value for Money Assessment Guidance*.

¹² HM Treasury: *PFI: meeting the investment challenge* (July 2003), p.32.

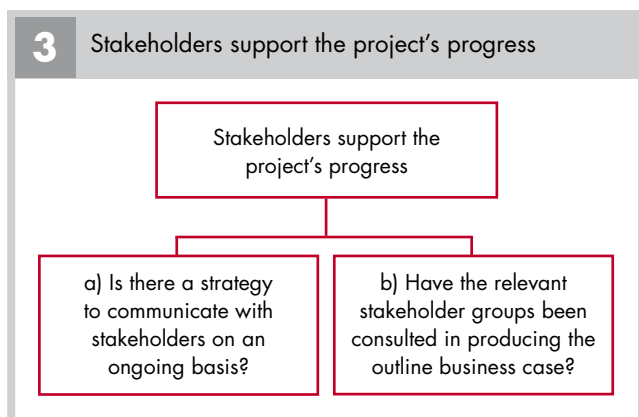
f) Is the optimal project structure for the Authority deemed acceptable for potential private sector partners and funders?

2.18 The evaluator needs to assess whether the project structure that is optimal for the Authority is deemed acceptable for potential private sector partners and funders, i.e. is the private sector capable of delivering the required outcome and is there the spare capacity in the market to do so? Market soundings can be an important part of preparing a value for money project as it allows for suggestions that can improve the project. However, the Authority must ensure that it does not change the proposed project structure from what was previously assessed as optimal just to make a PFI solution more attractive to the market. The evaluator should therefore:

- Examine which initial market soundings the Authority made to establish whether the private sector understood its requirements. For example, what guidance was provided to enable the private sector to understand what the Authority was hoping to achieve from the project?
- Confirm that any changes to the project’s scope and potential specifications made in response to private sector comments have been assessed as contributing to an improved solution for the project.

Stakeholders support the project’s progress

2.19 Throughout all stages of the project’s life, the Authority needs to ensure that stakeholders continue to affirm their support. At the initial stages of the project, the Authority should be considering how it communicates with its stakeholders and ensure they are involved in initial consultations over the project scope (see Figure 3).



a) Is there a strategy to communicate with stakeholders on an ongoing basis?

2.20 Stakeholders cover a diversity of interests and roles in relation to a project and individuals or groups inside and outside the Authority. Stakeholders can also be differentiated by those whose formal support are necessary for the continuation of the procurement or deal, and others whose acceptance, whilst desirable in the earlier stages, becomes more significant in the later stages of the deal, for example, future users of PFI infrastructure or services. It is important that the Authority should manage all its stakeholders well in order to achieve good value for money and facilitate smooth project procurement and operation. The range and composition of stakeholder groups varies according to what service or part of the public sector is covered by the project. **Figure 4** is an illustration of potential stakeholder groups and their key areas of interest.

4 Potential Stakeholder Groups	
Stakeholder	Key areas of interest
Parent Department	Affordability of Project; Risk Transfer; Value for Money
HM Treasury	Affordability of Project; Risk Transfer; Value for Money
Other public bodies (e.g. funders/purchasers)	Design of Asset: Affordability of Services; Fit with Business Requirements
Authority Senior Management	Service Specification; Affordability of Project; Risk Transfer; Value for Money; Design of Asset; Fit with Business Requirements
Staff	Service specifications; Design of Asset
Non-Staff users of service	Service specifications; Design of Asset
Local Community	Design of Asset; Environmental Implications of Asset
Potential Contractors	Price; Risk Transfer; Service specifications; Design of Asset

2.21 During this stage, the Authority should have identified potential stakeholders to be consulted. The evaluator should therefore check that the Authority has conducted an analysis of which stakeholder groups are relevant. The communication strategies should take account of the diversity in the type of stakeholders and their impact on the project. This points to a need to formalise how to communicate, its timing and procedures on how to handle unexpected information or new issues from stakeholder feedback. Where there are significant changes in stakeholder views on a project, there should be evidence of a re-appraisal or a stock-take on the project's progress. At this stage, the Authority should be identifying how best to conduct the consultation process and what its outputs should be.

b) Have the relevant stakeholder groups been consulted in producing the outline business case?

2.22 In drawing up the outline business case, the Authority should ensure that it has addressed the views of key stakeholders in the project. To ensure that the procurement outcome is a good asset design and has good service specifications, there should be adequate consultation with staff and end-users, gathering relevant feedback on the design of the project.

2.23 The evaluator should therefore gauge whether, in drawing up the outline business case, the Authority has taken sufficient steps to consult with those groups in assessing what the appropriate project structure could be and what outputs should be delivered as part of the project.

There is good quality project management

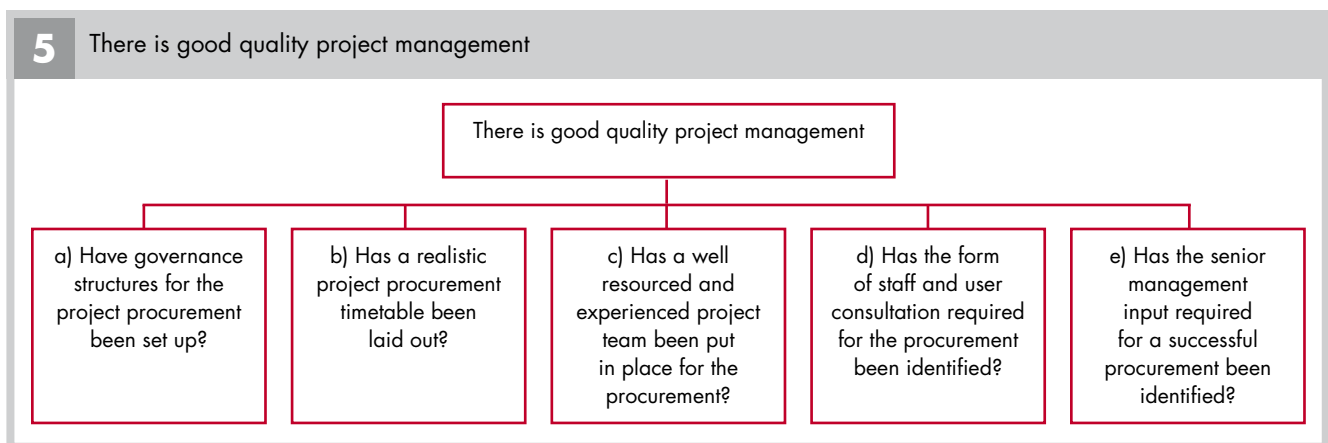
2.24 Good project management is needed, both ensure a good analysis of the options for delivery of the project and to put in place a good structure for the subsequent PFI procurement¹³. Five indicators (see Figure 5) have been identified:

a) Have governance structures for the project procurement been set up?

2.25 There is a need for governance structures that facilitate the procurement's progress and enable the Authority to manage their interest in and control of the project. The evaluator should check that:

- Roles and responsibilities for individual positions (such as Senior Responsible Officer, Project Sponsor and Project Manager) are clearly defined.
- The management structure for the project is clearly laid out with the responsibilities of decision making bodies, such as the project board clearly defined.

2.26 In summary, the evaluator should assess whether the project structure is in line with good procurement practice¹⁴.



¹³ Helpful guidance on procurement strategy is contained within OGC's publication *Gateway Review 2: Procurement Strategy*.
¹⁴ The Office of Government Commerce's *Successful Delivery Toolkit* provides advice on project roles and structures. The following web address highlights a helpful structure for programme/project delivery: <http://www.ogc.gov.uk/sdtookit/reference/roles/index.html>.

b) Has a realistic project procurement timetable been laid out?

2.27 During project procurement, it is important to maintain competitive tension, so that tenderers will feel under pressure to put forward their best possible bids. The Authority therefore needs to design a procurement timetable that is sufficiently brisk to maintain such tension but which allows sufficient time to enable important contractual and, where applicable, technical issues to be settled before selecting the winning bidder.

c) Has a well resourced and experienced project team been put in place for the procurement?

2.28 If the Authority is to implement a PFI project successfully, it is essential to have the right project team in place. During the Strategic Analysis phase, the evaluator should check that the Authority identified not only its skill requirements but also the stage of the project at which they would be required in order to ensure its success. One key project team member who is the project manager should have been appointed at the beginning of the project development with the expectation that this individual will stay with the project until financial close. A project manager not only sets timetables for all phases of the project and monitors progress against these but also will be responsible for resolving any problems as they arise, so that they do not cause delay.

2.29 The other internal members of the project team should include people with the appropriate procurement expertise, including a team member with a very good knowledge of UK and EU procurement law. To obtain external expertise as required, such as for legal and financial advice and for technical expertise, the Authority should appoint advisers with previous successful experience of PFI, generally using a competitive process. The evaluator should expect to see that the candidates for such appointments have been able to produce references from previous clients, which the Authority has taken up.

2.30 Other issues that the evaluator should consider in assessing the quality of the project team include:

- Whether adequate procedures have been put in place for managing the risk that the Authority's knowledge of the procurement detail is lost through staff departures.
- Whether sufficient staff resource has been allocated to the project. Experience indicates that senior management time in particular is essential in developing a good procurement.
- Whether the Authority has incorporated lessons learnt from previous PFI procurements or sought experiences from similar procurements.

d) Has the form of staff and user consultation required for the procurement been identified?

2.31 The Authority's project management structure should contain a process for consulting with staff and end-users. Individuals who will be receiving the services to be provided under the potential PFI contract can provide helpful insights into how improvements can be made in both the asset and service design.

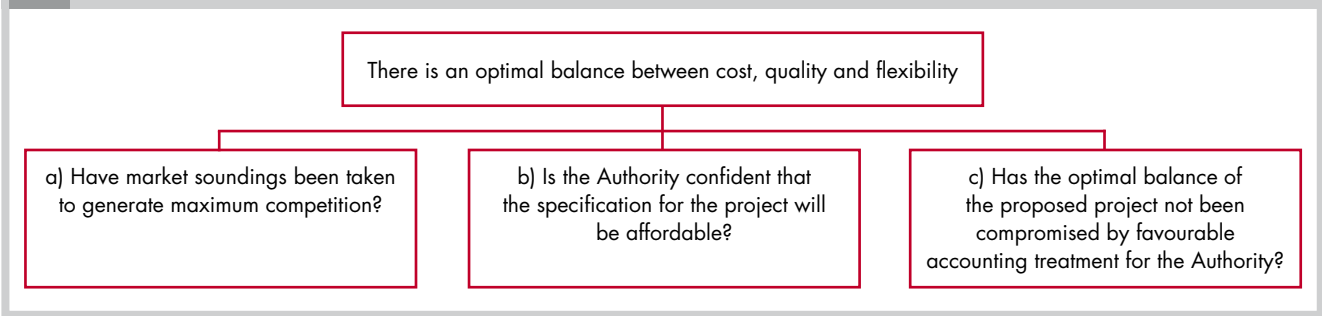
e) Has the senior management input required for a successful procurement been identified?

2.32 The Authority should identify at this early stage what form of senior management input is required for a successful procurement. This should include not only nominating a senior manager responsible for project delivery but also identifying what commitment other senior managers need to give to the project. Such commitment will include management time for project oversight as well as contributions to the output specifications where the project will have an impact on individual senior managers' areas of responsibility.

There is an optimal balance between cost, quality and flexibility

2.33 The Authority should be demonstrating in the outline business case that the chosen option for the project represents the best chance of obtaining the specified benefits at an affordable price that is value for money. In determining whether the Authority has achieved this outcome, the evaluator should assess the three indicators in **Figure 6 overleaf**.

6 There is an optimal balance between cost, quality and flexibility



a) Have market soundings been taken to generate maximum competition?

2.34 Maximising competition is the primary way of enhancing value for money for the Authority. The Authority should investigate the market sufficiently early in the project to ensure that there are suppliers who are willing and competent to bid for the work. Considerations that the evaluator should bear in mind when assessing this are:

- Where the project involves a complicated technical specification, the best time to meet potential suppliers is when the output specifications are being drawn up. This is because the Authority will need to have an idea of what the private sector is capable of delivering at what broad cost before defining the outputs.
- Otherwise, the Authority should define the outputs it expects from the project and then approach the market to promote interest in the project.

b) Is the Authority confident that the specification for the project will be affordable?

2.35 The evaluator should confirm that the Authority has analysed the potential costs of the project and earmarked (and confirmed if possible) funding streams to cover these costs.

c) Has the optimal balance of the proposed project not been compromised by favourable accounting treatment for the Authority?

2.36 The project structure should not be determined by balance sheet considerations¹⁵. The evaluator should be wary of any changes to the project’s structure, made as a result of accounting advice in relation to balance sheet treatment. Key areas of a PFI contract that may be changed to get a favourable balance sheet treatment are detailed at **Figure 7**.

Effective risk allocation and management is taking place

2.37 As part of the Strategic Analysis phase, the Authority should have identified the risks associated with the project (the project risk) and with procuring the project (the procurement risk) and proposed procedures with which to mitigate these risks, should they occur. **Figure 8** notes the two indicators by which the evaluator can assess how well the Authority is conducting its risk management.

¹⁵ See HM Treasury: *Value For Money Assessment Guidance* (2004), p 3, 1.3.

7 Key areas of a PFI contract that affect balance sheet treatment

Risk structure

Greater contractor acceptance of demand risk (e.g. via third-party income) than might be expected, or deliberate public sector "management" of demand risk to ensure it is understated. Where demand risk is significant, it is a strong indicator of which party should record the asset.

Higher than necessary unitary payments, in order to persuade contractors to take on residual-value risk on buildings. Where residual-value risk lies with the public sector, this may indicate a financing arrangement.

Length of contract is deliberately increased to reduce the Depreciated Replacement Cost value and the Net Present Value of the residual value risk.

Financing structure

Deliberate introduction of equity or quasi-equity (up to 10 per cent) to ensure bank financing is kept at 90 per cent or below. More than 90 per cent bank financing might be considered to represent a financing arrangement and hence be classified as on-balance sheet.

Payment structure

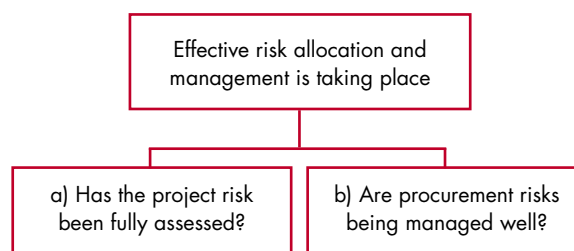
Contract is deliberately structured to ensure there are no provisions for partial termination of individual services (for example, as a result of continued poor service performance), as this would give an indication of on-balance-sheet treatment.

Payment mechanism is deliberately structured so that no element is specifically related to the level of debt and interest outstanding to the private sector on the facilities provided.

Provisions for benchmarking and market testing are deliberately structured so that hard FM services are inseparable from the payment for the property, to help ensure off-balance-sheet treatment.

Indexation, where applied within the payment mechanism, is applied to ensure annual maintenance and life-cycle costs are included in the un-indexed element or the whole unitary payment is indexed by a fraction of RPI, so as to ensure that the contractor retains a degree of operating cost risk.

8 Effective risk allocation and management is taking place



a) Has the project risk been fully assessed?

2.38 Cost effective risk allocation between the public and private sectors is a key requirement in achieving value for money on PFI projects. If the Authority seeks to transfer a risk that the private sector cannot manage well, then value for money will become reduced as the private sector seeks to charge a premium for accepting such risks. The Authority should therefore seek, not the maximum, but rather the optimum transfer of risk, which allocates individual risks to those best placed to manage them. The evaluator should check whether the Authority has identified the risks associated with the project and the scope for transferring them to the private sector and also assessed whether the proposed risk allocation is sensible.

2.39 The evaluator should check that the assumptions for valuing transferred risk are supported by an adequate audit trail that justifies the cost attached in the light of historical experience generally. This check should be a part of the evaluation of the quantitative analysis, justifying the decision to proceed with a PFI procurement.

b) Are procurement risks being managed well?

2.40 The Authority should have identified the risks associated with proceeding with the project and put in place a mitigating risk management plan. The evaluator should seek assurance that the Authority has addressed all the significant identifiable risks associated with continuing with the procurement and that it has put in place realistic procedures for mitigating such risks if they occur.

PART THREE

Tendering

3.1 During this phase, equivalent to Stage 3 of the 2004 Treasury VFM Guidance¹⁶, the Authority should be maximising the chances, given a substantiated decision to use PFI, that the outcome of the Tendering process will result in a preferred bid that offers the best possible value for money.

The project fits with the business requirements of the Authority

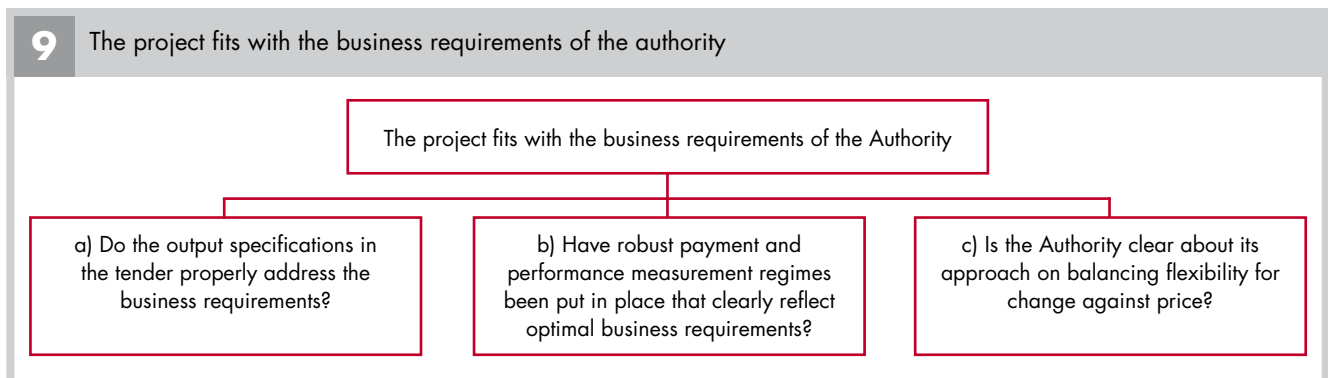
3.2 The Authority should produce output specifications and payment and performance regimes that address the business requirement, as reflected in the indicators in **Figure 9**.

3.3 The detail of the output specifications and the performance measurement system should be formulated before the Tendering stage starts, ideally with much completed before the outline business case is finalised¹⁷.

a) Do the output specifications in the tender properly address the business requirements?

3.4 In producing specifications for the service required, the Authority should:

- Involve staff (and end-users, if relevant) in identifying the requirements for the new asset and service provision and, where applicable, managing their expectations to ensure they are realistic.
- Discuss their requirements with potential bidders ahead of issuing tender documentation to establish whether they are practical and whether there is scope for improvement.
- Use consultants with the appropriate knowledge to provide advice where the Authority does not have the in-house expertise to develop the specifications.



¹⁶ Stage 3 of the Treasury Guidance is an iterative process which continues to financial close.

¹⁷ This facilitates a more detailed option appraisal at the outline business case stage and also speeds up procurement once the decision to proceed with a PFI option is taken.

3.5 The specification of requirements should be incorporated in the Tendering documentation distributed to prospective bidders. The evaluator should verify that these specifications were output based and consistent with the project's objectives identified at the Strategic Analysis phase.

3.6 In reaching an opinion as to whether the Authority succeeded in creating a good specification of its requirements, it will be necessary for the evaluator to canvass the views of all the firms that bid for the contract. It can also be helpful to ascertain whether the Authority sought advice and guidance from other authorities that had formulated output specifications for similar PFI procurements. It may be necessary to seek external expertise in this area to review, for example, the Authority's specification of requirements.

b) Have robust payment and performance measurement regimes been put in place that clearly reflect optimal business requirements?

3.7 It is key prior to the Tendering stage that the Authority has formulated a robust payment mechanism and performance measurement system (PMS) that are clearly linked to its business requirements. The Authority must thoroughly understand how the proposed payment mechanism and PMS will work, especially if consultants have been used to draw them up. Failure to achieve this can lead to dissatisfaction over service performance and/or the operation of the PMS and payment mechanism once the contract is operational.

3.8 For the PMS it is important that:

- The performance measures are well defined and capable of objective measurement. This will minimise disagreements between the public sector and contractor once the contract is operational.
- There should be an efficient division of responsibility for monitoring performance and checking the accuracy of the PMS. Both parties need assurance that the system will be accurate, but this must be balanced against excessive auditing of the PMS by either party.

3.9 The payment mechanism should be structured so as to encourage the contractor(s) to deliver the service to the level expected. To incentivise the contractor to provide the required service level, full payment should depend on good delivery of the required services and payment deductions should be levied for poor delivery of services. Deductions should be calibrated such that failure to provide the most critical aspects of service incurs higher penalties. The evaluator should seek evidence that:

- The values attached to penalties are calibrated so that non-compliance costs the contractor more than any saving made by failing to deliver the service.
- Adequate modelling of potential outcomes for non-compliance has been carried out.
- An assessment has been made of potential adverse outcomes of the payment mechanism, i.e. whether the mechanism incentivises behaviour by the contractor that is sub-optimal to the Authority.

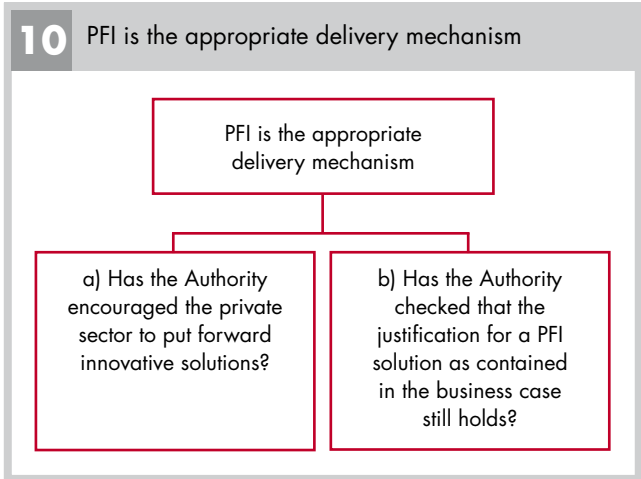
Is the Authority clear about its approach on balancing flexibility for change against price?

3.10 The Authority must ensure that adequate change mechanisms are proposed for the contract. Over the term of the PFI contract, the demands made on the Authority will change and the level and type of service it requires from the PFI contract are also likely to change. For example, new building space may be required or, alternatively, space may no longer be needed, whilst service specifications may need to be altered.

3.11 The evaluator must therefore seek evidence that the Authority has properly addressed this issue, by assessing whether the Tendering documentation includes adequate procedures for introducing changes to the Authority's requirements. The Authority must understand that the greater the flexibility it seeks for introducing subsequent changes to the contract, once operational, the higher the risk profile for the private sector will be and hence the higher the price of bids. The evaluator needs to establish that the Authority has adequately analysed the cost trade off for long term operational flexibility and taken a decision on what is acceptable. For example, the Authority should have undertaken an assessment of potential changes and carried out a risk analysis to determine which areas are likely to be varied over the contract period.

PFI is the appropriate delivery mechanism

3.12 Having decided on a PFI procurement route, the Authority should ensure that the private sector has the opportunity to propose innovative value for money solutions for delivering the project. In addition, the Authority should be checking that the justification for a PFI solution is maintained throughout the Tendering phase, as per the 2004 Treasury VFM Guidance¹⁸. **Figure 10** details the two indicators that address these issues.



a) Has the Authority encouraged the private sector to put forward innovative solutions?

3.13 A good range of proposed solutions from bidders can demonstrate that the Authority has encouraged innovation, thereby contributing to a good PFI deal. The evaluator should assess whether, during the Tendering phase, bidders suggested a variety of practical innovative solutions in a number of areas including:

- **Design Variants.** Asset design is likely to afford the greatest scope for innovation, mainly because it has a significant impact on the level of building and operating costs. The evaluator should examine how much freedom bidders were given to propose different design solutions and be satisfied that the Authority did not reject innovative designs simply because they challenged presumptions or established practices.
- **Operational Variants.** The evaluator should assess whether the Authority was open to new ideas from bidders on how to operate and deliver the required services, while at the same time ensuring that those ideas were deliverable. As the initial period of operations can pose particular risks (e.g. a new service provider operating with a new asset will need time to bed down operations), the evaluator will need to satisfy themselves that the Authority sought sufficient information from bidders as to how they would deal with these risks under their solution variant.

¹⁸ HM Treasury: *Value for Money Assessment Guidance* (August 2004), p. 11.

- **Financing Variants.** Financing charges are usually a significant part of a contractor's expected costs and the evaluator should be satisfied that the Authority sought bids that were based on obtaining finance through competitive procedures and took into account the best sources of finance the market could offer. The evaluator must also examine how the Authority assured itself that the proposed rates of return were reasonable. The use of funding competitors should have been considered seriously.
- **Output Variants.** Although the Authority should have clearly expressed the outputs expected from the project, bidders should have had the opportunity to add value by suggesting alternative outputs. The evaluator should therefore assess how the Authority balanced being open to innovative suggestions with the need to treat all bidders fairly. If the Authority decided to pursue a bid that did not conform to the specification, the evaluator must check that the appropriate legal advice was obtained to support this decision.
- **Risk Transfer Variants.** Value for money will be maximised where risks are allocated to the parties best able to manage them. The evaluator should assess whether the Authority obtained solutions that clearly stated how risks would be allocated. Guidance available from the Treasury and from individual departments on appropriate contract terms and early market soundings should have enabled the Authority to seek bids on the basis of a risk transfer that would achieve value for money and be acceptable to bidders.¹⁹ Evidence of lengthy negotiations on contract terms after the appointment of a preferred bidder can suggest either that the information on risk allocation previously requested from bidders could have been improved or that the Authority had little success in agreeing the contract terms with bidders before this.

Where there is a particular risk that is unusual or where there is uncertainty about the risk allocation that will produce the best value for money, the evaluator should identify whether the Authority obtained information from bidders on the effect on prices of alternative risk allocations prior to the tender. This would have enabled the Authority to evaluate whether it was worth transferring the risk to the private sector. Authorities should, however, avoid asking bidders to prepare a large number of alternative pricing

calculations based on different allocations of risk, as this will make large demands on the bidders' time and inflate bidding costs.

b) Has the Authority checked that the justification for a PFI solution as contained in the business case still holds?

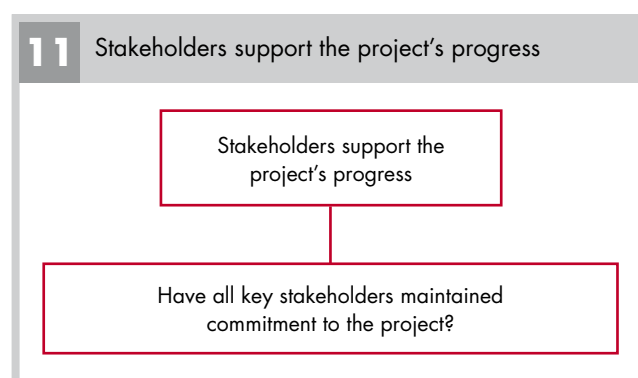
3.14 The evaluator should check whether, after the preparation of the initial option appraisal in the OBC, the Authority regularly reviewed the project as the procurement progressed, to identify whether it was still on track²⁰. Such reviews are necessary to enable early corrective action and, in exceptional circumstances, to determine whether the project is still worthwhile.

Stakeholders support the project's progress

3.15 It is important that the Authority maintains stakeholder engagement in the project during the procurement through its consultation and communication processes (see Figure 11).

Have all key stakeholders maintained commitment to the project?

3.16 Where stakeholders are integral to a successful tendering exercise, suggested actions to be taken by the Authority have been addressed in paragraph 3.4. Other key stakeholders, such as parent departments or the Treasury, should be kept informed of progress with the project where appropriate or required.



¹⁹ HM Treasury: *Standardisation of PFI contracts (Version 3)*, 2004.

²⁰ HM Treasury: *Value for Money Assessment Guidance*, HM Treasury, August 2004, p. 33.

3.17 The Authority's senior management have an internal stakeholder role. It is important that before the procurement goes to a preferred bidder stage, they accept or approve the projected whole life costs in the most economically advantageous bid as capable of being funded within the available budget.

There is good quality project management

3.18 Experience indicates that a successful outcome to the procurement of projects requires both a good project management structure and good management of the process itself. Six indicators are shown in **Figure 12**.

a) Has a good project team been maintained for the tendering phase?

3.19 Maintaining a good quality team throughout the procurement phase is vital towards getting a good deal. The issues noted in the Strategic Analysis phase for putting together a good project team obviously still apply for the procurement phase. Key additional factors that the evaluator should consider are:

- Whether the project team has access to sufficient expertise when required in the procurement process.
- Whether the project team contains staff with good negotiating skills.

b) Has a clear and realistic timetable for tendering been put in place and maintained?

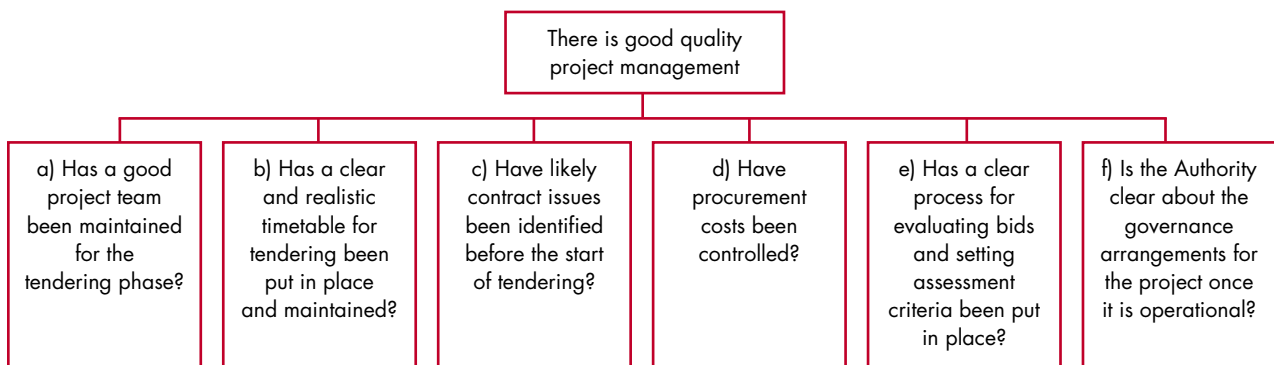
3.20 The Authority will need to re-assess at stages throughout the Tendering phase whether the timetable originally drawn up remains realistic. If it is not, then there should be evidence that the authority has re-considered the timetable and made suitable adjustments in the interests of achieving best value for money.

Have likely contract issues been identified before the start of tendering?

3.21 The evaluator should examine whether, before Tendering begins, the Authority identified the contractual issues that were likely to arise. Treasury, Standard Contract and departmental guidance, plus experience from letting previous PFI contracts, should help inform this analysis. Key contractual issues such as risk allocation, the payment mechanism, service levels and performance monitoring, change mechanisms, and deductions for poor performance have been dealt with in depth elsewhere. Other issues that the Authority should have identified include:

- **Length of contract.** In determining the optimum length of the contract period, the Authority should have given careful thought to its future service needs. In general, the contract should be short enough to give the Authority flexibility if its needs change but long enough to encourage serious commitment from the contractor and be consistent with the economic life of the asset in question.

12 There is good quality project management



- **Covenant: customer to pay, supplier to perform.**
The Authority should have established early on in the formulation of the project that it had the authority to enter into the contract and had the resources necessary to meet all of its obligations during the contract. Similarly, in order to ensure continued delivery of the required services in the event of serious failure by a contractor (or sub-contractor), the Authority's contract proposals should allow for the replacement of a (sub-) contractor at as little cost as possible.
- **End contract: asset transfer and residual value.**
If the deal involves the transfer of public sector assets to the private sector and their return at the end of the contract, the Authority should consider how they will ensure that the contractor will maintain them to the required standards.
- **Refinancing arrangements.** Mechanisms to clawback part of any future refinancing gains that the contractor may earn should be put in place. Authorities should ensure that their proposals for any such clawback is in line with official guidance, for example that refinancing gains should be shared 50:50 between the private and public sector²¹.
- **External audit access.** The Authority should consult in advance with their external auditors as to the access the latter are likely to require to the contractor's cost and performance information for audit purposes. For bodies audited by the National Audit Office, the contract should require the contractor to maintain separate records of the costs of performing services specified under the contract and to allow the Comptroller and Auditor General and his representatives access to these records.

d) Have procurement costs been controlled?

3.22 The Authority needs to control procurement costs.

Key questions for the evaluator to ask are:

- Have the advisers been appointed after competition?
- Have realistic budgets for each work stream been set and updated where appropriate²²?
- Have costs for each work stream been monitored and managed?

e) Has a clear process for evaluating bids and setting assessment criteria been put in place?

3.23 A clear process for evaluating bids and setting assessment criteria should have been put in place.

The evaluator should check that:

- Clear guidelines for liaising with bidders were drawn up. For example, who was responsible for communicating advice and feedback to bidders, what information on the state of the tendering process was allowed to be disclosed to bidders, and how were the bidders to be informed of the outcome of tendering? The evaluator should confirm that such guidelines were followed.
- Clear assessment criteria were set in advance of Tendering and communicated to bidders;
- Competition between bidders has not been distorted. For example, where further information has been requested by a bidder, it has been supplied to all the other bidders as well.
- The weighting of evaluation criteria was in line with business objectives.
- Specialist sub-groups were set up to evaluate the different components of the bids (e.g. financial, quality of service, financial stability of bidders, risk transfer and design quality).
- A transparent decision making process was in place to assess the bid offering best value for money.

²¹ HM Treasury: *Standardisation of PFI Contracts (Version 3)*, 2004, p260, 35.5.3.

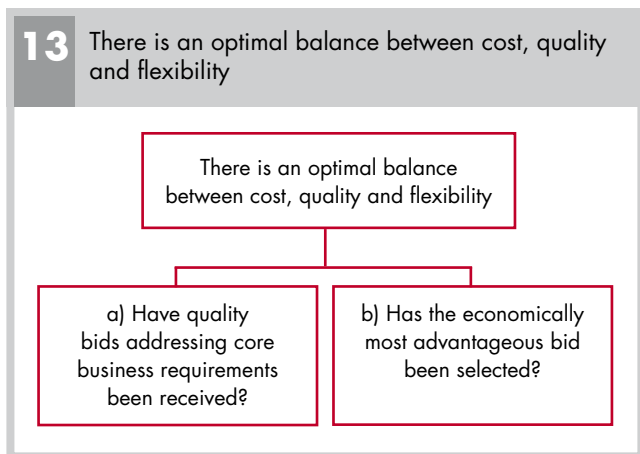
²² Benchmarking budgets against similar procurements can be helpful here.

f) Is the Authority clear about the governance arrangements for the project once it is operational?

3.24 Before the Tendering phase begins, the Authority should be considering the governance arrangements it requires for the project once it becomes operational. Formal issues such as dispute resolution procedures should be included in the proposed contract. Relationship issues, such as how often senior public and private sector management or operational level managers should meet, do not necessarily have to be included in the contract. Instead, the Authority’s proposals for dealing with such issues can be incorporated in other documents, for example, in the Tendering document as a statement of intent. The Authority should aim to agree a formal statement of governance arrangements later, once a preferred bidder has been selected but before financial close.

There is an optimal balance between cost, quality and flexibility

3.25 For a positive outcome for this theme, the Authority should have received good quality bids and then selected a preferred bid that has clearly demonstrated that it is the economically most advantageous. **Figure 13** details the two indicators that reflect this outcome.



a) Have quality bids addressing core business requirements been received?

3.26 As has been stressed previously, competition helps generate value for money. Therefore, the first indicator for this theme stresses that a sign of good value for money is that the Authority has received a sufficient number of quality bids addressing its core business requirements. The evaluator should consider that three bids would be a reasonable number to receive for the final stage of bidding.

b) Has the economically most advantageous bid been selected?

3.27 Measures of success in achieving a good outcome are that:

- The preferred bid is affordable and confirmed to be so with public sector budget holders.
- The preferred bidder has a good track record, i.e. the contractors and sub-contractors have experience in provision of the relevant services and working within a PFI contract.
- The contractor(s) have the financial strength to cope if delivery goes wrong.
- The proposed design of the asset has been deemed suitable for business requirements.
- The proposed operational solution is deemed suitable for business requirements.
- Value for money is being achieved without employees’ terms and conditions being inconsistent with TUPE requirements.
- Value for money remains the criterion rather than balance sheet treatment.
- There are no major outstanding issues which reflect value for money, e.g. details of a PMS that will be agreed only after signing the contract.
- There is evidence that best value for money has been achieved in the light of information available at the time, and in comparison to other procurement alternatives.

3.28 It is important that the assessment of bids has taken account of whole lifecycle costs and the impact of the proposed designs on sustainable issues; for example, energy usage and greenhouse gas emissions. Further guidance is contained in Annex 2 (Valuing Non-market Impacts) of HM Treasury’s Green Book.

Effective risk allocation and management is taking place

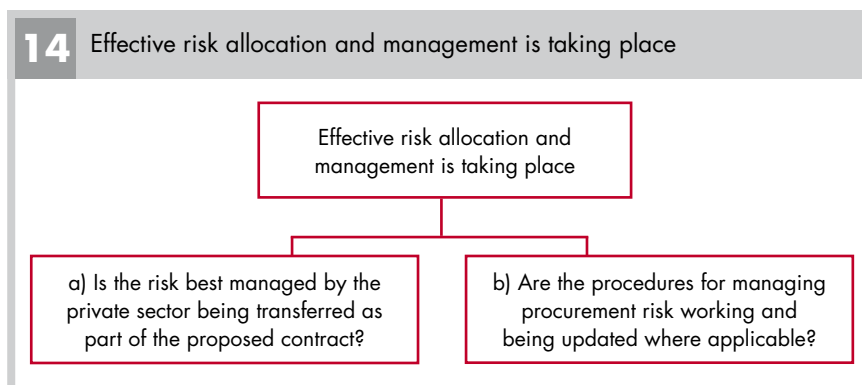
3.29 The indicators for this theme, **Figure 14**, cover whether proposed risk allocation remains optimal and whether good management of procurement risk is being maintained.

a) Is the risk best managed by the private sector being transferred as part of the proposed contract?

3.30 The evaluator should check that the risk capable of being transferred to the private sector as identified at the Strategic Analysis phase has actually been incorporated in the proposed contract. The evaluator should also check that, where applicable, the Authority has checked the appropriateness of the valuations attached to each risk identified. This is particularly important when there is either a significant change to the project since the OBC or when the market response is markedly different to that expected at the start of tendering²³.

b) Are the procedures for managing procurement risk working and being updated where applicable?

3.31 It is likely that the risk management plan that the Authority should initially have put in place during the Strategic Analysis phase will need to have been updated during the Tendering phase. The evaluator should check that such updates have been being made to ascertain whether the risk management plan is actually being used as an effective management tool. The evaluator should also review whether the risk management plan is being properly used, i.e. that mitigating actions proposed are actually being implemented if necessary.



²³ The presumption in Treasury's 2004 VFM guidance is against re-evaluating the PSC and hence risk valuations during the tendering stage.

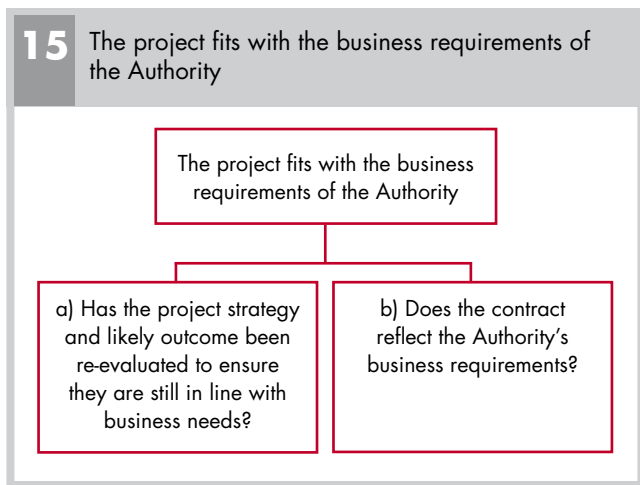
PART FOUR

Contract Completion

4.1 Once the preferred bidder has been selected, it is important that the Authority carefully manages the process up to financial close, avoiding any significant variations that may contravene new EU procurement law. In addition, the Authority should be looking further ahead by ensuring it has in place arrangements for managing the project once the contract has been signed.

The project fits with the business requirements of the Authority

4.2 The ideal outcome to be reached by the time of contract close is a deal that reflects the current and foreseeable business needs, as reflected in the indicators in **Figure 15**.



a) Has the project strategy and likely outcome been re-evaluated to ensure they are still in line with business needs?

4.3 There is no point pursuing a project that is unlikely to meet the Authority's business needs. Such a situation can arise if the terms available in the market (i.e. what the preferred bidder is prepared to sign up to) are not satisfactory or if the Authority's objectives have changed. Just before signing the contract, the Authority's senior management should therefore conduct a review to determine whether the proposed deal still meets business needs, asking whether the original objectives for the project are still valid and, if not, whether the proposed deal fits with the latest circumstances²⁴. It is important that this review should take account not only of policy changes occurring during procurement but also of any such changes likely to occur in the foreseeable future. The evaluator should check that such a review has been conducted.

4.4 A key issue here for Authorities to consider is that they should be wary of changing their objectives during the procurement of a project. Aside from the risk of increasing procurement costs, it can be seen by potential tenderers as increasing the risks of dealing with the Authority and reduce their future prospects of getting good PFI deals. If an Authority considers changing its objectives during procurement, it should seek legal advice as to what changes can be made without being exposed to the risk of legal challenge from the bidders.

24 OGC's Gateway Review 3: Investment Decision can provide such an assessment for the Authority.

b) Does the contract reflect the Authority's business requirements?

4.5 In reviewing the proposed contract before signing, the following should be considered by senior management:

- Does the contract reflect the deal that has been negotiated?
- Are handover/termination arrangements clearly specified?
- Are there appropriate sanctions/bonuses within the payment regime to incentivise the contractors?
- Are the performance measures in line with business requirements?
- Are there appropriate provisions for dealing with changing requirements?

4.6 In checking that the contract reflects the deal that has been negotiated, the evaluator will need to review whether the contract sets out as clearly as possible what the contract covers and its terms, with few ambiguities or omissions. The evaluator will also need to review the provisions in the signed contract for termination and handover arrangements and the payment regime, to assess whether they provide the contractor with sufficient incentives, and the Authority with adequate safeguards, to ensure the services will be delivered to the required standards. It is important that the performance

measurement system (PMS) should provide information that can not only be used for calculating service payments and any deductions or bonuses, but is also helpful to the Authority's management in running the business. The evaluator should therefore review the PMS for its adequacy as an effective information system.

4.7 Lastly, the evaluator should assess the contract provisions for handling changes to the Authority's requirements, examining whether these provisions include adequate procedures for resolving any disputes over pricing and any other aspects of proposed changes. In reaching conclusions about the adequacy of those arrangements, the evaluator may need to seek the advice of legal and other specialist external consultants.

PFI is the appropriate delivery mechanism

4.8 It is important that, in the period before contract close, the Authority reviews the structure of the proposed deal, to confirm that a PFI deal remains the best solution for the project. This review, which should confirm the desirability of proceeding with the deal and, if there are doubts about the PFI solution, that reasonable alternatives were examined. The review can be carried out at the same time as assessing whether the project meets business needs.

4.9 As detailed in the 2004 Treasury VFM Guidance, the Authority can carry out a high level check of underlying costs against an appropriate range of benchmarks.²⁵ This guidance requires the Authority to be sure that the bid offered is not significantly above the PFI market price for similar projects or that the risk profile has not been eroded relative to other similar PFI projects at this price. In such a situation, which is unlikely to lead to a value for money transaction, the procurement should be halted and the Authority should consider other alternatives for the project or cancel it.

4.10 The evaluator should therefore check that such a review of the appropriateness of the PFI solution has been conducted to ensure that all decisions taken by the Authority on either proceeding with or cancelling the PFI solution at this late stage are adequately supported with evidence, such as cost benchmarking.

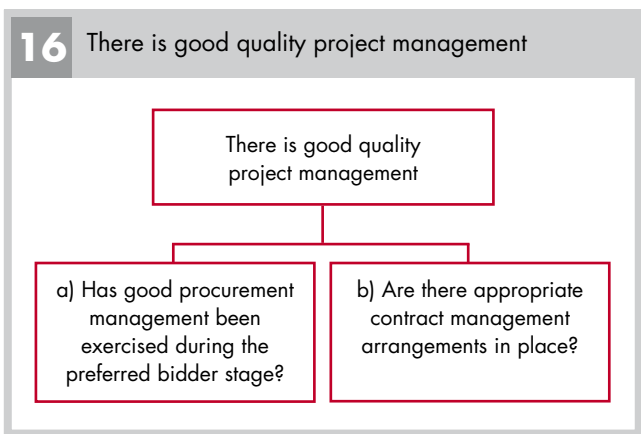
Stakeholders support the project’s progress: commitment from all parties

4.11 Stakeholders should be kept informed of progress in negotiating the final contract and the Authority should ensure that they agree to the final structure of the deal. When assessing the communication and consultation undertaken in this phase, the evaluator can seek evidence by reviewing the final business case, where key stakeholders should be expected to signal their agreement to the project, and by interviewing a wider range of relevant stakeholders to hear their views on whether they were adequately briefed on the negotiations.

4.12 Where stakeholders are making or expected to make specific financial contributions to the project then the evaluator should expect to see their explicit sign up to the project.

There is good quality project management

4.13 The Authority must ensure that there are no significant changes to the deal and put in place the right contract management arrangements to come into effect immediately once the contract has been signed. These two issues are reflected in the indicators for this theme, shown in **Figure 16**.



a) Has good procurement management been exercised during the preferred bidder stage?

4.14 The points left for further discussion must be kept to a minimum in line with EU procurement law. In assessing that the preferred bidder stage has been well managed, the evaluator will wish to see that the Authority has:

- Limited the difference between the terms in the winning bid and those obtaining at the time of contract award.
- Kept delays in getting to contract close to a minimum.
- Kept outstanding issues at contract close to a minimum. Any such outstanding issues remaining should have no substantive impact on the future price of the deal.

4.15 Care must be taken to ensure that any changes requested in the deal specification do not either render the deal poor value for money as compared with the next best bidder or fail to comply with EU procurement rules. Key areas that the Authority should be concerned about and which the evaluator should review when assessing the value for money of changes during the preferred bidder stage are:

- **The financial aspect of the deal.** The tender price should not normally have changed after the preferred bidder has been appointed, other than for authority initiated changes to the service specification (though these should as far as possible be avoided²⁶). Bidders should therefore provide a commitment with their final tender to keep their bid price fixed during any subsequent negotiations. An exception is for the effect of interest-rate movements to be factored into

²⁵ HM Treasury: *Value for Money Assessment Guidance*, (August 2004), pp. 36, 31.

²⁶ Any such changes must be in line with relevant procurement law.

the tender price up to the date of contract letting. The evaluator should seek explanations for any price changes occurring during this phase and assess the value for money implications of such price variations.

- **Risk allocation.** This is an area where the preferred bidder or their financiers may have sought changes in the closing stages. The evaluator will be able to identify any such changes by comparing the signed contract with the draft version at the time the preferred bidder was selected. Any changes in risk allocation will have implications for the deal's value for money and the evaluator must gather evidence that the Authority correctly assessed such implications. The evaluator should examine the contract to verify how the risks have been dealt with and to identify any additional contractual risks that the Authority may not have been aware of. Good practice on the part of the Authority would be following the guidance for key risks allocation contained in SOPC 3²⁷ (or the relevant sector guidance) and the production of a summary showing how the major risks have been allocated, with appropriate cross-references to the relevant contract clauses.
- **Other changes.** Design and/or operational changes should have been kept to a minimum in this phase of the project. Where changes have been made, the evaluator should establish that there was a valid reason for them and that they were deemed not to affect the deal's value for money or distorted competition.

b) Are there appropriate contract management arrangements in place?

4.16 This indicator focuses on the importance of having appropriate contract management arrangements in place before awarding the contract so as to ensure that Authority staff responsible for monitoring the contract are fully prepared once contract close is achieved. The Authority should ensure that it has in place procedures that address each of the following four issues:

- Have responsibilities for monitoring the contract been established?
- Has the Authority ensured that key staff monitoring the contract have the required knowledge and skills?

- Are there appropriate arrangements for feedback to the contract management team from Authority staff interfacing with the project? and
- Are there appropriate processes for resolving day-to-day operational issues?

There is an optimal balance between cost, quality and flexibility

4.17 The Authority should be seeking a signed deal that is affordable, has got the best financing available and has been deemed the economically most advantageous on offer. This is reflected in the indicators in **Figure 17 overleaf**.

a) Is the deal affordable in the short and long term?

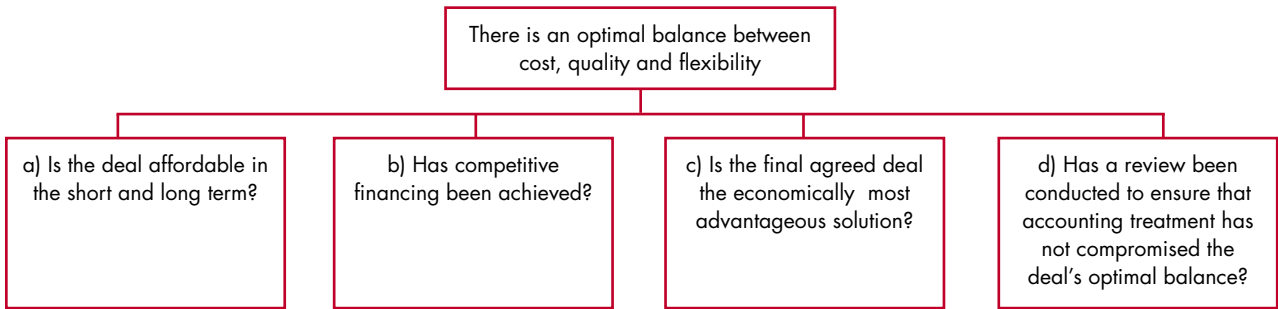
4.18 Although the Authority should have been keeping the project's affordability continuously under review as procurement progressed, the evaluator will need to identify whether the Authority made one last check, before signing the contract, on the availability of any capital funds required (where the public sector is providing some of the finance for the capital works on the proposed asset) and of the revenue funding needed to meet the payments under the contract once service delivery begins.

b) Has competitive financing been achieved?

4.19 The cost of finance will be a key determinant of the price of the deal and hence its value for money. The evaluator will need to establish that the financing arrangements were competitive at the time of financial close. Evidence will include whether a financing competition was held or, if it was not, whether the Authority's financial consultants analysed the financing structure at the time of deal close. This analysis should include an assessment of the state of the financial market at the time of close and of whether interest rates on the senior debt were deemed competitive.

27 HM Treasury: *Standardisation of PFI Contracts (Version 3)*, 2004.

17 There is an optimal balance between cost, quality and flexibility



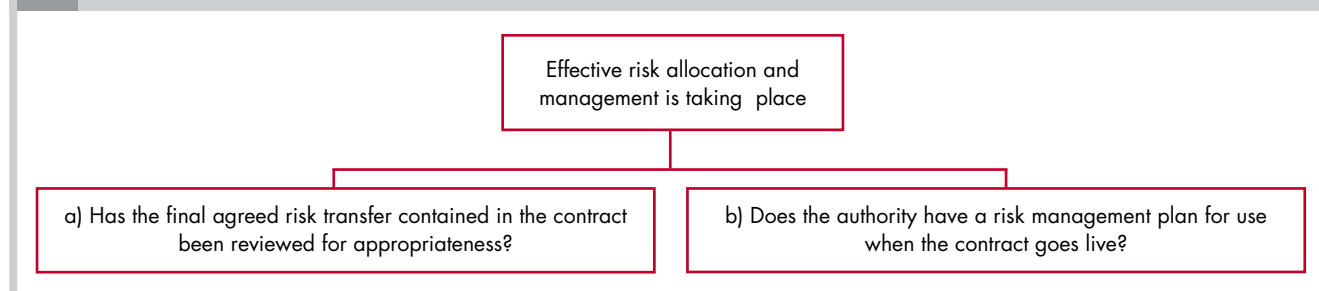
c) Is the final agreed deal the economically most advantageous solution?

4.20 The final agreed deal should ideally offer the Authority the best value for money solution. The evaluator needs to seek assurance that what was on offer was the best available, seeking evidence that final asset design and service specifications were assessed against what is required by service users. Trade offs with affordability will have been made and therefore the evaluator should consider whether the Authority made a sufficient case. This assessment by the Authority should be part of a final business case justifying the deal signed at contract close, in which the benefits of the proposed asset and services have been demonstrated to justify the costs.

d) Has a review been conducted to ensure that accounting treatment has not compromised the deal's optimal balance?

4.21 The Authority should have conducted a second review to ensure that the deal's optimal balance has not been compromised by its accounting treatment. The evaluator should seek assurance that changes to the project have not been driven by the need for favourable accounting treatment. In making this assessment, the evaluator should make use of the considerations outlined in Figure 8 on page 13.

18 Effective risk allocation and management is taking place



Effective risk allocation and management is taking place

4.22 Before signing the contract, the Authority should be satisfied that it is well placed to deal with the risk associated with the project, as outlined in the indicators in **Figure 18**.

a) Has the final agreed risk transfer contained in the contract been reviewed for appropriateness?

4.23 The Authority should have reviewed whether the risk transfer contained in the proposed contract was appropriate, i.e. that risk best managed by the private sector contractor has been transferred, and that risk best managed by the public sector has been retained. The evaluator should examine the risk assessment and assess

the validity of any assumptions made over risk transfer, seeking explanations for any risk transfer or retention that is not in line with the Standard Contract guidance.

b) Does the Authority have a risk management plan for use when the contract goes live?

4.24 The evaluator should also establish that the Authority has put in place a risk management plan for when the contract is signed, with proposals for mitigating any risks that might occur. Key top level considerations are:

- Does the Authority have plans in place if the contractor(s) fail to deliver the asset as planned?
- Has the Authority considered the implications of the contractor(s) failing to deliver the contracted services and have they put together plans for mitigating this risk?

PART FIVE

Pre-Operational Implementation

5.1 The value for money indicators for this phase of a project's life-cycle are limited. As this phase is concerned with the delivery²⁸ of the asset, the indicators provide a check on good progress.

The project fits with the business requirements of the Authority

5.2 The sole indicator for this theme at the Pre-Operational stage seeks confirmation that the asset is being delivered to contractual specification. The evaluator should seek confirmation on three key questions:

- Is the asset being delivered to time?
- Is the asset being delivered to quality?
- Is there any increase in the unitary payment?

5.3 In checking that the work on any new or, where applicable, refurbished asset is proceeding both to timetable and to quality, the evaluator should seek evidence from any reports produced by independent consulting engineers employed by the public sector to provide regular reports on the project's progress. These reports should be checked against milestones and specifications contained in the contract and any discrepancies identified and explanations sought.

5.4 Where there is a failure to deliver on time or where the construction outcome is deemed not to meet contractual specifications, the evaluator must check that the Authority is not paying for the relevant service.

Construction risk should rest with the contractor and the Authority should only start paying the unitary payment once the asset is deemed to be in a fit state for use.

5.5 In checking the unitary payment, the evaluator should seek reasons for any agreed increase in the amount payable. As PFI seeks to transfer the risk of cost overruns to the private sector, the evaluator should not expect to see any increase in the future unitary payment, other than those caused by inflation uplifts and authority initiated contract variations.

PFI is the appropriate delivery mechanism

5.6 Having re-checked that PFI is justified as the delivery route at the time of Contract Completion, the evaluator needs only to confirm that baselining of what was achieved from pre-contract assets is continuing.

5.7 Where a new asset is being constructed and the PFI contractor is only contracted to provide services once the new asset is operational, the Authority should still be measuring quality of service provision. The Authority should therefore continue to baseline its own equivalent service provision in the old asset (whether provided in-house or contracted out) until the new asset becomes operational.

5.8 Where a new asset is being constructed but service provision within the old asset has been transferred to the PFI contractor at contract completion, the Authority should benchmark the contractor's service provision in the

²⁸ Or, in some cases, the "handover" of an asset that is to be used by the public sector but maintained by the private sector.

old asset. This provides for two types of analysis that will assist the Authority in gathering an evidence base of which procurement methods work best:

- A current analysis of whether the PFI contractor's service provision in the old asset shows any improvement or decline in quality against the previous service provision (whether in-house or by another contractor). This aims to provide evidence of the quality of different service providers.
- A future analysis of the PFI contractor's performance in the new asset as compared to their performance in the old asset, which aims to help provide evidence of whether service provision improves in the new asset. This should facilitate any subsequent assessment of the quality of the asset's design.

5.9 By gathering evidence that the Authority has carried out the benchmarking detailed above, the evaluator can gain assurance that the Authority is in a strong position to carry out a detailed analysis of whether the PFI procurement route is delivering concrete benefits once the asset becomes fully operational.

Stakeholders support the project's progress

5.10 The Authority should maintain regular contact with key stakeholders (including staff and end users) to keep them informed of progress in the asset's construction.

By maintaining good relationships with the relevant stakeholders, the Authority will be able to better manage their expectations about the outcome of asset construction.

5.11 The evaluator should seek confirmation, where applicable, that such contact is taking place, for example seeking:

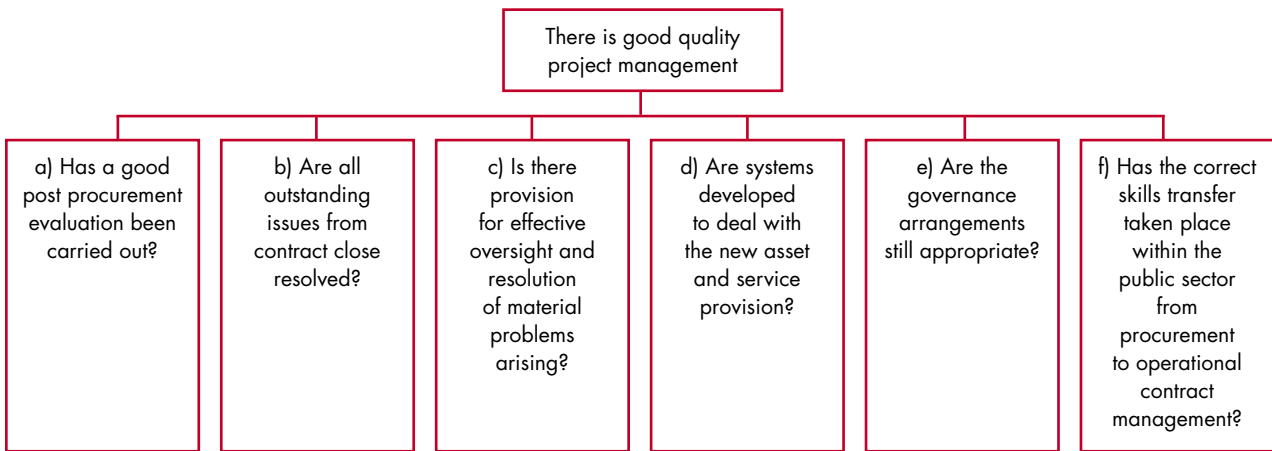
- Evidence of the completion of progress reports or the holding of progress meetings to inform parent departments or Authorities.
- Presentations to end users such as members of the public, where they have a direct stake in the outcome of the project, e.g. a healthcare development.
- Workshops and presentations to members of staff.
- Meetings with other organisations, where the project has an impact on the wider environment, for example, it is part of a wider regeneration project.

There is good quality project management

5.12 The Authority should be looking to ensure that a post-procurement evaluation has been carried out and that it is meeting its responsibilities towards making sure that the new asset is completed on time, whilst also ensuring that it has the procedures in place to deal with the Early Operational phase of the contract once the asset is completed²⁹. **Figure 19 overleaf** details the relevant indicators.

²⁹ OGC's *Gateway Review 4: Readiness for Service* provides the opportunity for Authority to receive feedback on its readiness for the start of service delivery.

19 There is good quality project management



a) Has a good post procurement evaluation been carried out?

5.13 It is important that the Authority should evaluate the success (or otherwise) of the project’s procurement. This evaluation should focus on the procurement and the lessons to be learnt from the outcome; it should not be an evaluation of the project itself. The evaluator should check whether the Authority has taken account of the following considerations in any such analysis and subsequent action:

- Has the evaluation considered if the staffing for project procurement was appropriate?
- Was there evaluation of the use of external advisers to check whether the price paid was justified by the quality of advice?
- Was there effective planning and management of the procurement?
- Have the lessons from such an evaluation been disseminated for wider learning?

b) Are all outstanding issues from contract close resolved?

5.14 In the past when PFI was a new procurement route, it was not uncommon for issues to have been left unresolved at the time of contract close. Where such cases still arise, the evaluator should determine that the Authority is well placed to ensure that the outstanding issues are resolved in a timely fashion consistent with maintaining good value for money. The evaluator should seek evidence to answer the following two questions:

- Has a clear timetable for resolving such issues been produced?
- Is a clear project-management process in place for ensuring the issues are resolved achieving good value for money?

5.15 The longer a point outstanding at contract close remains unresolved, the greater the risk is to both the timely completion of the project and to future costs for the Authority.

c) Is there provision for effective oversight and resolution of material problems arising?

5.16 The construction and delivery of a new asset can be a risky process and the evaluator must be certain that the Authority has in place provisions for the effective oversight and resolution of any material problems that might arise. The evaluator should check that a process has been agreed between the Authority and the contractor for resolving any problems, that the appropriate levels of management staff are committed to problem resolution procedures and that the Authority has a fall back plan in place in case there is a delay to the asset becoming operational. In projects involving high technological or business critical work, such options should have been thought about in the Contract Completion phase if not earlier.

d) Are systems developed to deal with the new asset and service provision?

5.17 The Authority's working practices are likely to change when a new asset comes on stream, with new providers of associated services. It is therefore important that the Authority develops systems to deal with the new asset and service provision. The evaluator should assess whether the Authority has properly briefed its staff on the changes to be expected once the operational phase commences and also whether both parties have developed appropriate procedures for managing the handover period.

e) Are the governance arrangements still appropriate?

5.18 The evaluator should check if the Authority has reviewed whether the governance arrangements put in place before contract close are still relevant once construction of the asset is under way. For example, the evaluator should determine whether:

- Regular progress meetings between the contractor and Authority are taking place.
- The Authority feels that it is sufficiently well informed of project progress.
- The contractor is being kept informed of the Authority's strategic thinking about future use of the asset and the contracted services.

f) Has the correct skills transfer taken place within the public sector from procurement to operational contract management?

5.19 With the contract now under way, the skill set which the Authority needs for the project moves from procurement to contract management skills. The evaluator should assess how well the Authority has managed this transfer and whether it has in place the right skill set for the future. Issues that the evaluator should check include:

- Determining whether the Authority has a sensible resource plan for moving from delivery of a signed deal to the operational phase, i.e. if enough staff are devoted to managing and running the handover.

- Confirming whether the Authority has procedures in place for transferring knowledge of the contract detail from the bid negotiation team to the contract management team.
- Whether there is staff continuity, at least temporarily, from the Authority's deal team to the operational management team.

There is an optimal balance between cost, quality and flexibility

5.20 In this phase of the project, the important consideration is that any increases in the unitary payment should relate only to changes to the asset specifications and/or service requested by the Authority. The evaluator should seek assurance that such changes were a priority for the Authority and are agreed on terms that are assessed as being both good value for money and affordable. The evaluator should check that sources for funding the increase are actually available to the Authority.

Effective risk allocation and management is taking place

5.21 The Authority should have identified the risks it faced on the project once the contract was signed and should have had a risk management plan in place. The evaluator should assess whether the Authority's risk mitigation procedures are working properly and check that the risk management plan is being regularly reviewed and updated during the construction of the asset. Particular risks that may occur that the evaluator should look for and seek evidence of updated risk mitigation procedures include:

- Any early teething problems where there is a phased introduction of new (or refurbished assets).
- Potential lack of availability of infrastructure and/or services caused by construction delays.
- Unexpected costs arising from the operation of both existing pre-contract facilities and also potentially from the new facilities.

PART SIX

Early Operational

6.1 We have defined the Early Operational phase to last around three years from the commencement of service with the new asset, (or transfer of asset). This figure is based on NAO experience looking at PFI deals in the operational phase and reflects our assessment of how long it takes before early operational problems are ironed out and a constructive relationship between private and public sectors has been fully developed.

The project fits with the business requirements of the Authority

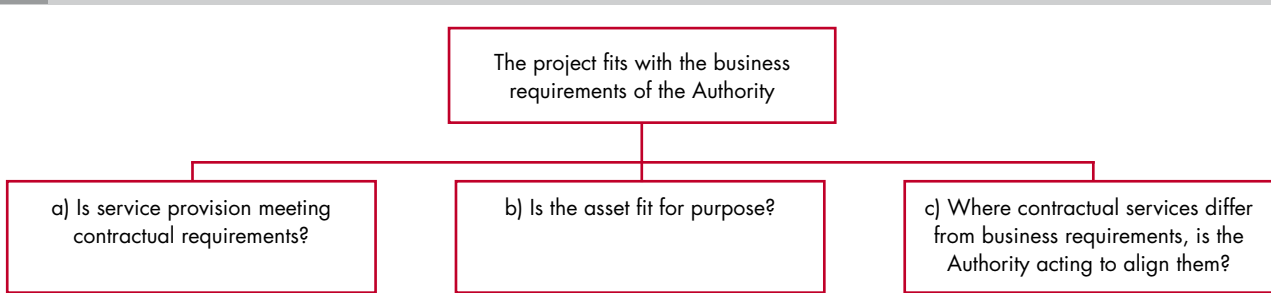
6.2 At this stage the evaluator needs to identify, as shown in **Figure 20**, whether the service contractor(s) are delivering to contract, whether the newly completed asset is fit for purpose, and whether the Authority is taking steps to identify whether the contract, now in operation, is in line with business requirements.

a) Is service provision meeting contractual requirements?

6.3 The evaluator needs to assess whether the performance measurement system (PMS) and payment mechanism are working effectively. For the PMS, the evaluator should check the following:

- Is the contractor providing timely performance information?
- Does the PMS cover all the services under the contract?
- In terms of their objectivity, are the performance measurement criteria acceptable?
- Does the Authority believe that it is receiving accurate performance data?
- Are the contractor(s) monitoring performance through a quality management system?

20 The project fits with the business requirements of the Authority



- Is the Authority reviewing the contractor's quality management system? and
- Are procedures for service users to report failures in place and are they fully utilised?

6.4 Similarly, the evaluator should check whether the payment mechanism is functionally effective. The Authority should have considered these issues when designing both the PMS and payment mechanism, but should re-assess whether, as designed, they are actually working in practice. Considerations that the evaluator should bear in mind are:

- Does the payment mechanism cover all relevant aspects of the Authority's business?
- Does the payment for services reflect the level of service provided?
- Does the payment mechanism seek to make deductions for substandard performance?
- Has the Authority reviewed the impact and appropriateness of contractual incentives?

b) Is the asset fit for purpose?

6.5 Once the asset is operational and is being used to deliver new services, there should be maintenance schedules for maintaining it on a pre-planned basis. The evaluator should check that these schedules are being adhered to and that the building is assessed as being maintained to sufficient standard in relation to the contract provisions. Most of this information should be contained with the PMS documentation. The evaluator should also

review how quickly the contractor responds to problems raised by staff, as well as canvassing staff views (at both the Authority and the contractor) on the quality of the asset.

c) Where contractual services differ from business requirements, is the Authority acting to align them?

6.6 As there can be a long time lapse between the date of contract close and the start of service provision using the new asset, it is possible that the Authority's business requirements will have changed in the intervening period. The evaluator must ask two key questions to gain assurance that the Authority is actively monitoring the effectiveness of the contract to its business:

- Has the Authority assessed whether the service levels contained in the contract meet the business requirements? and
- Has the Authority taken steps to resolve any discrepancy?

6.7 The evaluator should bear in mind that the Authority should allow the contract to "bed down" before initiating any changes, i.e. allowing time for both parties to reach full agreement on how the PMS and payment mechanism should be interpreted in practice and allowing the contractor the opportunity to overcome any initial teething problems with service provision. It is clearly in the best interests of the Authority to ensure that this 'bedding down' period is as short as possible. The evaluator should therefore ascertain that both parties reached as early an agreement as possible on how to interpret the PMS and payment mechanism.

PFI is the appropriate delivery mechanism

6.8 If the asset is deemed to be totally inappropriate for the Authority’s business requirements, for example, in the event of a poor construction outcome, the evaluator should check what actions the Authority took to re-assure itself that maintaining the PFI project was the best value for money. The evaluator should consider the following:

- Did the Authority consider termination?
- Was the cost of termination evaluated?
- Were alternative service delivery mechanisms realistic and available, based on earlier risk planning?

Stakeholders support the project’s progress

6.9 The Authority should be checking that stakeholders in the project are satisfied with the initial performance of the new asset and services. Given the teething problems that deals can experience in the early operational phase, there remains a need for a communication strategy to be in place for staff and service end users. The evaluator should check that the Authority assures itself as to stakeholder support by means of the following key questions:

- Is the Authority periodically canvassing stakeholders including end users for their views on how the asset and associated services are performing?
- Is the Authority taking steps to address concerns raised by stakeholders?
- Is there ongoing satisfaction with the level of service from contractors? and
- Is the Authority communicating appropriately about key or major issues that concern stakeholders?

There is good quality project management

6.10 For this theme, the evaluator should seek assurance that the project management is based on good skills, structures and relationships (see Figure 21).

a) Are the governance structures being used appropriately?

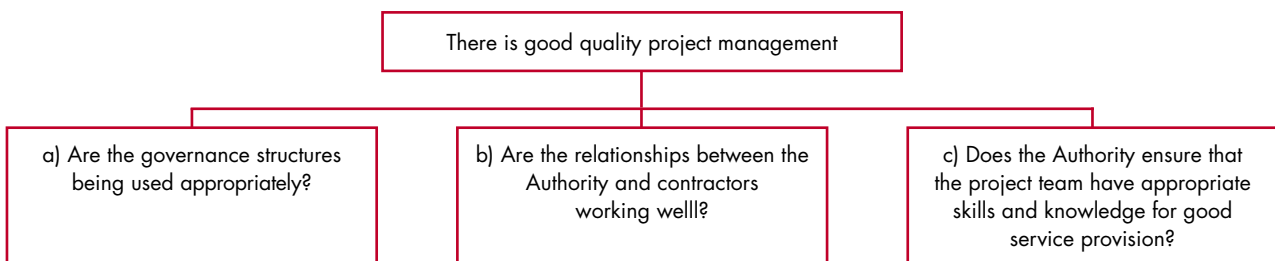
6.11 The evaluator should check that the governance structures initially designed for the project are working in practice. The evaluator should also assess whether minor problems and issues concerning the operation of services are being addressed at the relevant junior or middle-management level, for example, weekly and monthly meetings between operational staff on both sides. Strategic issues and major service related problems and disputes should be within the remit of the top tier of the governance arrangements, e.g. quarterly meetings between senior contractor and Authority management. Where senior Authority managers are becoming involved in minor operational discussions this may indicate that governance structures were badly designed or non-existent.

b) Are the relationships between the Authority and contractors working well?

6.12 For a project to run smoothly, it is important that both parties have a good working relationship with a shared understanding of the Authority’s business objectives. The evaluator should assess the state of such relationships at both senior management and operational level. At the senior management level, key considerations to be borne in mind include:

- Whether the contractor has been kept abreast of the Authority’s strategic direction.

21 There is good quality project management



- Whether an open and honest environment has been created between the contractor and the Authority.
- Whether both parties have developed a common business focus for the project.

6.13 At the operational level, key considerations for assessing the state of the relationship are:

- Do PFI company staff have an appropriate understanding of the Authority's business?
- Are relationships being facilitated by co-location of services?
- Are Authority staff easily able to contact the relevant individuals from the PFI company to discuss issues?

c) Does the Authority ensure that the project team have appropriate skills and knowledge for good service provision?

6.14 The final indicator for good project management in the Early Operational phase is whether the project team have the appropriate skills and knowledge for good service provision. Contract management staff should have a detailed knowledge of the contract. Too often, Authority staff responsible for monitoring PFI contracts at the start of the Operational phase do not have sufficient knowledge of the requirements of the contract. The evaluator should seek evidence that a structure is in place for ensuring monitoring staff clearly understand their roles; this could include job descriptions clearly stating the roles and responsibilities of contract management staff and a contract management manual.

6.15 The Authority and the private sector managers should have processes for learning from experience and developing improved systems for managing the contract. The evaluator

should look for evidence that both the parties regularly evaluate the performance of the contract management team; that external consultants are used where appropriate, i.e. when the Authority does not have the relevant internal skills; and that both sides seek to learn from the experience of other PFI projects and other Authorities.

6.16 Finally, the evaluator should review any procedures that the Authority has in place to deal with the loss of staff and knowledge associated with contract management, e.g. examining the project risk management plan.

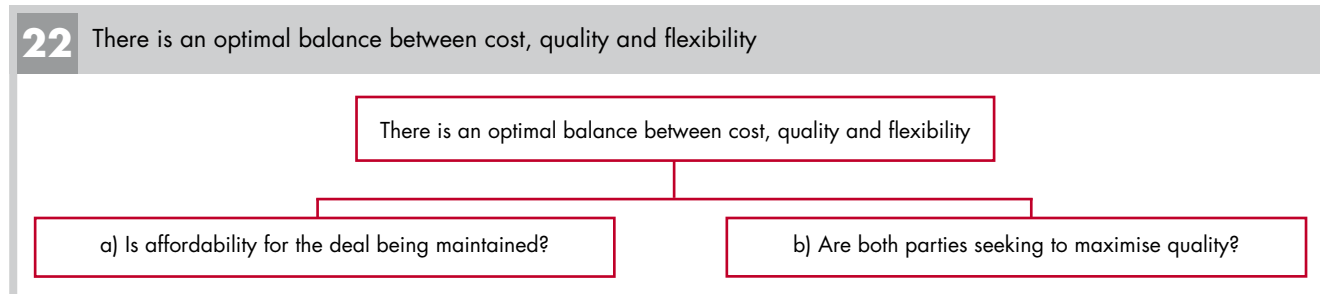
There is an optimal balance between cost, quality and flexibility

6.17 Within the contractually agreed terms, the Authority should be seeking to desire the best the quality of service from the contractor, while ensuring that the deal remains affordable, **Figure 22**.

a) Is affordability for the deal being maintained?

6.18 The evaluator should examine whether the Authority is putting in place the foundations for maintaining the long term affordability of the deal. Evidence that this is taking place would include:

- Whether both parties are working together to identify cost efficiencies.
- Whether the Authority and contractor have established the process and timing of future benchmarking and market testing exercises. The timing should have been specified in the contract but, in the former case, both parties will subsequently need to agree suitable comparative benchmarks to use³⁰.



³⁰ The Government intends to amend the standard PFI contract to provide greater flexibility for the soft services provision. This will require the provision of soft services to be actively completed and market tested at appropriate points during the PFI contract. HM Treasury: *PFI: Strengthening Long Term Partnership*, (2006) pp 9, 87.

b) Are both parties seeking to maximise quality?

6.19 If the quality of service provision is to be maximised, it is important that both parties are working together to achieve this goal. Key considerations for the evaluator are:

- Whether there is evidence that any innovations in service delivery are taking place.
- Whether both parties are benefiting from two way working for suggesting improvements to each other’s business.
- Whether there is a process in place for both parties to learn from their experience of the project in developing new ways of working together.
- Whether the contractor has taken active steps to improve quality where specific failures have been identified in the service.
- The costs and ease of making the minor variations likely to be needed in the early days are good value and can be completed without undue delays.

Effective risk allocation and management is taking place

6.20 The evaluator should assess using the following three indicators to assess whether risk allocation is still optimal and if the Authority is properly managing retained risk, **Figure 23.**

a) Has the allocation of risks been sustained operationally?

6.21 The evaluator should assess whether the risks associated with the operation of services – and assessed during procurement as being allocated to the contractor – have materialised or not. If, in practice, any risk associated with services is being passed back to the Authority, this should be interpreted as compromising the deal’s value for money.

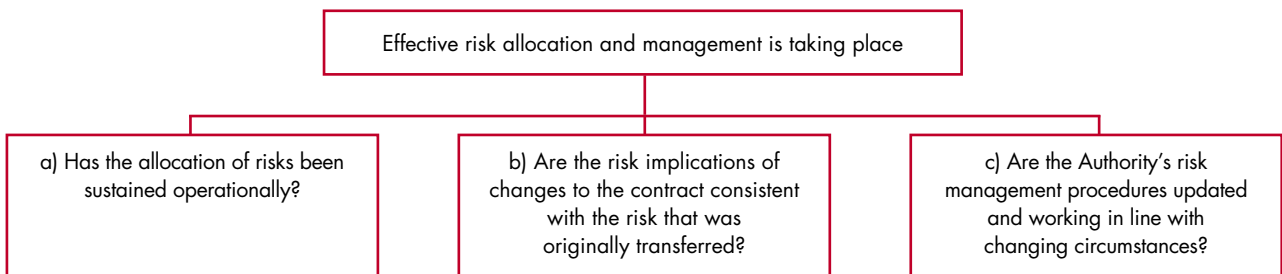
b) Are the risk implications of changes to the contract consistent with the risk that was originally transferred?

6.22 This indicator relates to whether any changes to the contract have altered the risk profile agreed at initial contract close. The evaluator should assess whether the value for money implications of the risk transfer on which the PFI solution was based have been undermined by contract changes that result in risk being passed back to the Authority. If risk has been passed back to the Authority as a result of a change, the evaluator should confirm that the Authority has benefited elsewhere, e.g. through a reduction in charges for service provision or through the contractor taking on risk elsewhere.

Are the Authority’s risk management procedures updated and working in line with changing circumstances?

6.23 The evaluator must confirm that the Authority is reviewing its risk management plan for the contract and updating its procedures so that it can address any future change in circumstances.

23 Effective risk allocation and management is taking place



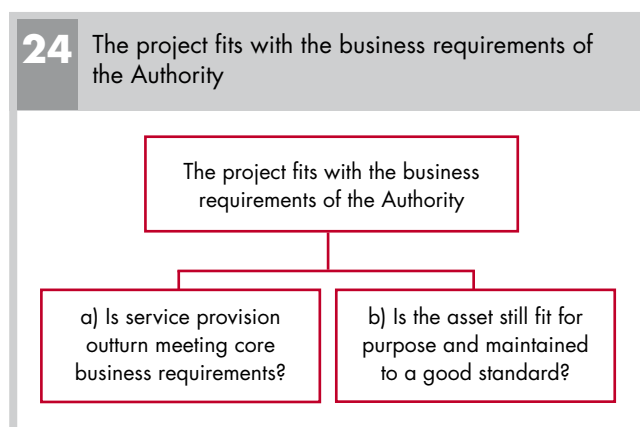
PART SEVEN

Mature Operational

7.1 As the operational period of the PFI contract progresses, value for money assessment focuses on how well the deal is meeting the Authority's longer term strategic needs³¹. At a simple level, it is asking whether the deal has the flexibility to cope with changes in circumstances that will occur over a period of 25 years or more and still provide value for money.

The project fits with the business requirements of the Authority

7.2 For the project to continue to work well, it is essential that the asset is well maintained by the contractor and that service provision meets whatever the Authority's current business needs may be (see Figure 24).



a) Is service provision outturn meeting core business requirements?

7.3 In assessing whether service provision outturn is meeting core business requirements, the evaluator should first check that the Authority has been regularly monitoring where contractual levels are not meeting business requirements. Where there is a discrepancy between business operational requirements and the level of performance required by the contract, the evaluator should examine what steps the Authority has taken to rectify the situation. The evaluator should expect to see that the standards of service provision expected from the contract are being updated to reflect a change in core business requirements.

7.4 Periodic benchmarking or market testing exercises should provide a good opportunity for confirmation of a revision to a PFI contract's service level agreement (SLA) component. Where changes to service levels have been made, the evaluator should check that subsequent service provision is meeting the revised SLA. Key questions that the evaluator should ask include:

- Does the Authority ensure that information generated by the performance measurement system is consistent with any update or change to the contract?
- Is the contractor meeting revised service requirements?
- Is the Authority reviewing the impact and appropriateness of the revised contractual incentives, i.e. is the payment mechanism working well?

31 The OGC Gateway review process suggests that PFI projects should be reviewed every three years. (OGC: Gateway Review 5: Benefits Evaluation).

7.5 In assessing any revised PMS and payment mechanism introduced, the evaluator may wish to consider using the detailed sub-indicators noted previously for this theme for the Early Operational phase, see paragraphs 6.3-6.4.

b) Is the asset still fit for purpose and maintained to a good standard?

7.6 The evaluator should also check that the asset remains fit for purpose and is being maintained to a good standard. Key questions are:

- Has the asset’s fitness for purpose been assessed?
- Are maintenance schedules being adhered to?
- Is the Authority checking that the any maintenance reserves required by the project funders are being managed to ensure sufficient monies are available for asset replacement and maintenance?

PFI is the appropriate delivery mechanism

7.7 After the project has been in the operational phase for a few years and initial teething problems have been sorted out, the Authority is in a better position to assess the benefits arising from taking a PFI procurement route. If the PFI deal has gone well, the Authority should be expecting improved performance levels compared to pre-PFI service provision. **Figure 25** details the two indicators that the evaluator should assess.

a) Has the Authority improved its performance since the PFI project became operational?

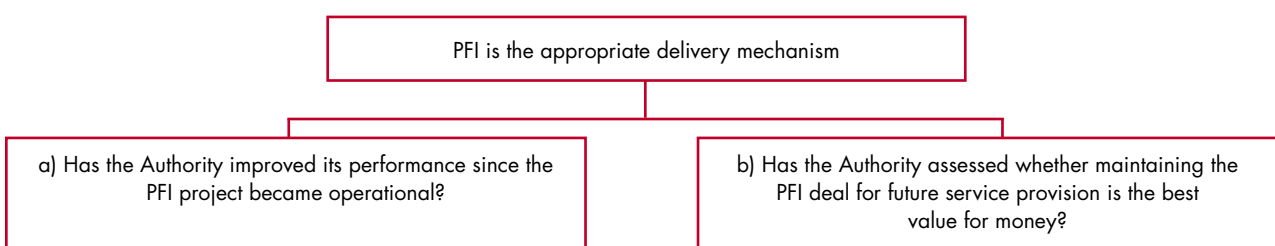
7.8 This first indicator refers to assessing the part of the Authority’s business covered by the PFI project.

In considering this indicator, the evaluator should seek evidence to answer the following questions:

- Has service provision (both PFI-delivered and that retained in-house) been compared to the previously baselined service provision?
- Have the outcomes identified as PFI-specific in the business case been realised? There may include aspects outside the immediate project. For example, efficiency gains elsewhere in service delivery may be attributable to learning experiences from managing and monitoring PFI contracts³².
- Has the PFI asset’s design outcome been assessed in a qualitative comparison with equivalent non-PFI assets?

7.9 It is difficult to assess what would have happened to a mature project if it had as far as possible gone down the PFI route. However, it is still important that such a comparison is made so that lessons from using the PFI route can be assimilated. Evaluation should consider comparator groups of assets financed conventionally as a guide.

25 PFI is the appropriate delivery mechanism



³² The NAO Report on ‘The Operational Performance of PFI Prisons’ (2003, HC 700, p5) noted the success of in-house management teams in bidding against private sector teams for the operation of prisons.

b) Has the Authority assessed whether maintaining the PFI deal for future service provision is the best value for money?

7.10 The Authority should periodically assess whether maintaining the PFI deal for future service provision is the best value for money, considering whether the costs of terminating the contract can be justified by the benefits arising from an alternative structure for providing the required services.

7.11 Where the underlying asset and contracted services are still required and the contractor is meeting the relevant contractual standards, the cost of breaking the contract is likely to be prohibitive as any termination liabilities that the Authority would have to pay to the contractor would outweigh the benefits of taking direct responsibility for the asset and services.

7.12 Termination of the contract is only likely to be a valid value for money option where either:

- The requirement for the contracted asset and services is fundamentally obsolete justifying a voluntary termination of the contract by the Authority or
- Service provision by the contractor is so poor that a termination on the grounds of contractor default is justified.

7.13 Where the contractor is failing to meet service specifications and the Authority is unhappy with the quality of service being delivered and is considering termination, it should evaluate the costs and benefits of termination, bearing in mind whether alternative delivery mechanisms are realistic.

7.14 More usually, projects will evolve through major variations to the contract, for example, to add or reduce capacity. The evaluator should check that the changes are preferable to terminating the contract and were achieved through a competitive process leading to good value for money.

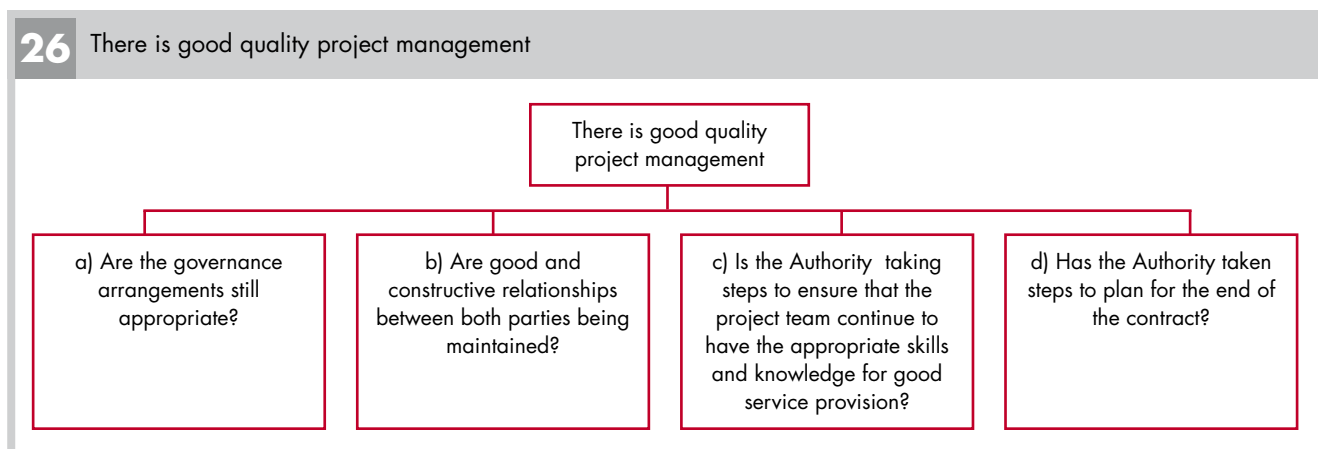
Stakeholders support the project's progress

7.15 The Authority must continue to confirm and maintain stakeholder satisfaction with the project. Central key questions that the evaluator should consider are:

- Is the Authority periodically canvassing stakeholders including end-users for their views on how the asset and associated services are performing?
- Is the Authority taking steps to address concerns raised by stakeholders?
- Is there ongoing satisfaction with the level of service from contractors? Evidence on this will, as in the Early Operational phase, be drawn from user satisfaction surveys carried out by the Authority.

There is good quality project management

7.16 The Authority should continue to maintain good skills, an appropriate governance structure and good relationships with the contractor to facilitate the management of the project (see Figure 26).



a) Are the governance arrangements still appropriate?

7.17 The Authority should be ensuring that it continues to have the appropriate governance arrangements in place. The evaluator should bear in mind two considerations when assessing whether this indicator is being met:

- Whether the Authority is conducting reviews of the project’s governance structures and that these structures are being updated in line with changing circumstances;
- Whether disputes over service provision are being resolved at the appropriate levels. Just as in the Early Operational phase, the evaluator should be checking that minor problems and issues are being addressed and resolved by the lower tiers of the governance structure, while the top tiers are used to discuss contract change, service improvement, business development and strategic direction, and to resolve major problems and disputes.

b) Are good and constructive relationships between both parties being maintained?

7.18 The quality of the relationship between both parties is key to maintaining the long-term value of the PFI deal. The key considerations outlined in the Early Operational phase still apply and the evaluator should use these in assessing the state of this relationship.

c) Is the Authority taking steps to ensure that the project team continue to have the appropriate skills and knowledge for good service provision?

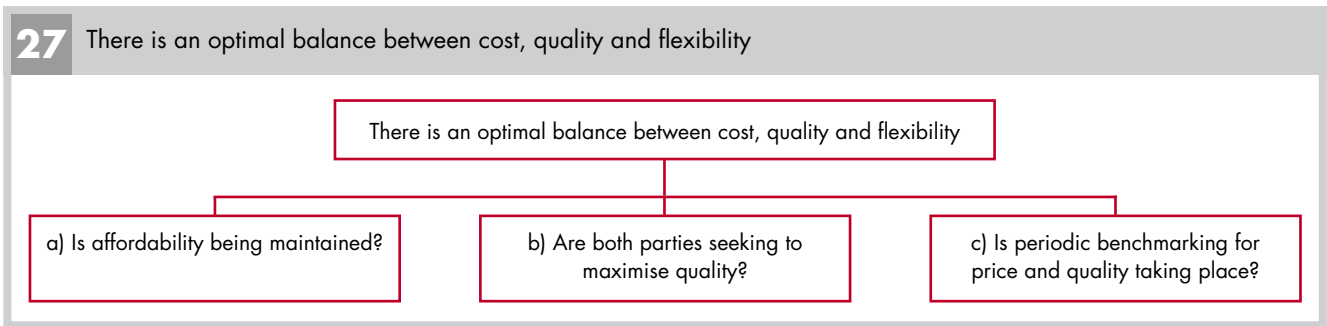
7.19 The considerations at this phase in assessing whether the Authority’s project team has the appropriate skills and knowledge are similar to those for the Early Operational phase. Additional considerations in this phase are whether any contract management manual is being updated and whether the Authority re-evaluates the skill sets required for managing the project to ensure that the appropriate staff are in post.

d) Has the Authority taken steps to plan for the end of the contract?

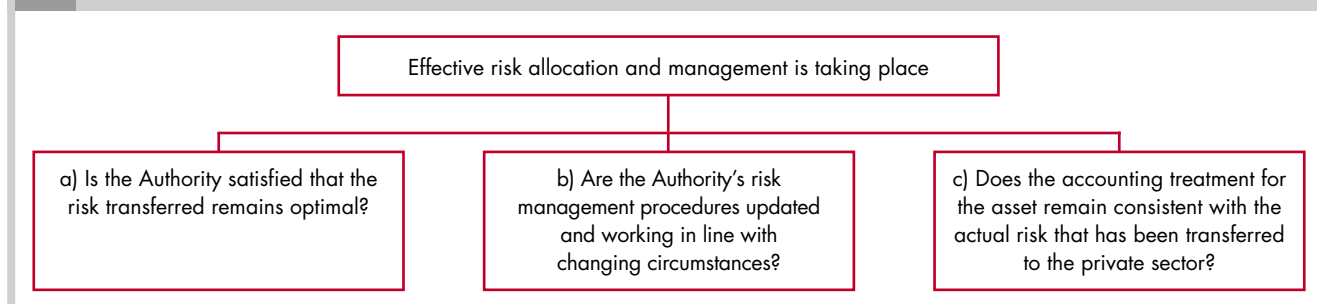
7.20 The final indicator relates only to the period leading up to the end of the contract, when the Authority should be taking steps to plan for subsequent service provision. It should have identified how services will be provided once the contract finishes, assessing the risks associated with the handover of the asset at that time and putting in place risk mitigation plans.

There is an optimal balance between cost, quality and flexibility

7.21 As with the Early Operational phase, the Authority should be seeking to maximise the quality of service being provided by the contractor, while ensuring that the deal remains affordable. The first two indicators in **Figure 27** replicate those for the Early Operational phase and should be assessed according to the criteria laid out in paragraphs 6.18-6.19.



28 Effective risk allocation and management is taking place



Is periodic benchmarking for price and quality taking place?

7.22 This indicator examines the benchmarking of services taking place, and the evaluator should assess whether appropriate benchmarks have been identified and, if applicable, used and whether the period of time between benchmarking exercises is appropriate.

Effective risk allocation and management is taking place

7.23 Again, as with the Early Operational phase, the evaluator should check that risk allocation remains optimal and that the Authority is properly managing any retained risk, **Figure 28**. An additional consideration that the evaluator should bear in mind is to check that the accounting treatment for the asset is consistent with the actual risk that has been transferred in practice.

7.24 Indicators a) and b) are similar to those for this theme in the Early Operational phase. The Authority should continue to:

- Remain satisfied that the risk deemed as being passed to the contractor at contract close is consistent with the risk actually being borne by the contractor.
- Ensure that the risk implications of changes to the contract are consistent with the optimal allocation of risk.
- Make sure its risk management procedures are updated and working in line with changing circumstances.

7.25 Indicator c) relates to ensuring that the accounting treatment for the underlying asset remains consistent with the actual risk that has been transferred to the private sector. The evaluator should confirm that the Authority's external financial auditors have re-evaluated the risks and rewards associated with the asset now it is fully operational and are content with the accounting treatment on the balance sheet.

ANNEX 1

Mapping the Matrix to other guidance

1 Strategic Analysis

a) The project fits with the business requirements of the Authority

Indicators	Further questions	Further guidance
Has the best form of project been selected?	Have clear objectives for the project been set?	OGC Gateway 0, p9, 2.1 Green Book p13, 4.1-4.2
	Does the project meet policy imperatives?	
	Was the project assessed as being priority?	
	Has a preliminary evaluation of the benefits sought been made?	OGC Gateway 1, p5, 1.1
	Has long term commitment to the project been demonstrated?	OGC Gateway 0, p7 1.1-1.3
	Are the project outcomes clear?	VFM Assessment Guidance,, p21, Table 5.1
	Have the project's wider socio-economic benefits been quantified?	Green Book, p19, 5.12; ,pp34-36; p 60, 22; pp61-62; p63, 37 PFI: Meeting the Investment Challenge, p28, 3.3, Bullet 4, p32, 3.15, Bullet 2 OGC Gateway 0, p9, 2.2
	Does the proposed solution clearly meet business requirements?	
Have top level output specifications for the services required been drawn up?		VFM Assessment Guidance, p21, Table 5.1

b) PFI is the appropriate delivery mechanism

Indicators	Further questions	Further guidance
Has the project been assessed as part of a suitable investment programme for PFI?		VFM Assessment Guidance, Stage 1
Has a good outline business case justifying a PFI procurement route been produced?		VFM Assessment Guidance, Stage 2
Are qualitative reasons for proceeding with PFI clearly justified?	<p>Can a viable PFI contract be constructed?</p> <ul style="list-style-type: none"> ■ Can programme level objectives and outputs be delivered by a PFI contract? ■ Is the Authority satisfied as to the operational flexibility of a PFI contract? ■ Is the authority satisfied that there are no overriding reasons for providing the service directly? ■ Is the private sector capable of delivering the required outcome? 	<p>VFM Assessment Guidance, p7, 1.17</p> <p>ibid., p22, Table 5.1</p> <p>ibid.</p> <p>PFI: Meeting the investment challenge p7, 1.27; p79, 7.4</p>
	<p>Has it been demonstrated that PFI would bring sufficient benefits?</p> <ul style="list-style-type: none"> ■ Is there sufficient scope for the transfer of risk to a private partner? ■ Is there likely to be scope for innovation? ■ Is the transfer of soft service provision essential for improved service delivery? ■ Can the service be assessed against an agreed standard? ■ Can the PFI payment mechanism incentivise the levels of service provided? ■ Is the service suitable to be managed on the basis of long term contractual relationship? ■ Is it possible to integrate the design build and operation of the project? 	<p>VFM Assessment Guidance (HM Treasury), p22, Table 5.1</p> <p>ibid.</p> <p>ibid.</p> <p>ibid.</p> <p>ibid.</p> <p>ibid.</p> <p>ibid.</p> <p>ibid.</p>
	<p>Is a PFI procurement achievable?</p> <ul style="list-style-type: none"> ■ Is there capability to manage the project and appraise ongoing performance against agreed outputs? ■ Is there likely to be sufficient market appetite for the project? 	<p>VFM Assessment Guidance, p24, Table 5.1</p> <p>ibid.</p>

Indicators (continued)	Further questions (continued)	Further guidance (continued)
Are the quantitative reasons for proceeding with PFI clearly justified?	Is there a comparison between the likely costs of the PFI option and a public sector comparator (PSC)?	VFM Assessment Guidance, p17, 4.1; pp 18-19, 4.4-4.6, 4.11
	Are the transaction costs likely to be manageable?	ibid., p30, 6.5-6.7
	Is it based on sound evidence from all types of past procurement experience?	ibid., p10, 2.4
	Is the overall project affordable?	ibid., p16, 3.18
	Has sensitivity analysis been undertaken to compute the effect of assumptions on the relative value for money of the procurement routes?	ibid., p27, 5.20
	Have the possible benefits as well as the costs of delivery options been quantified?	ibid., p6, 1.13
Has service performance been baselined for future monitoring of PFI contractor performance?		Standardisation of PFI Contracts (Version 3), p69, 9.2.2
Is the optimal project structure for the Authority deemed acceptable for potential private sector partners and funders?		PFI: Meeting the Investment Challenge, p81, 7.12

c) Stakeholders support the project's progress

Indicators	Further questions	Further guidance
Is there a strategy to communicate with stakeholders on an ongoing basis?		OGC Gateway 0, pp 5, 10
Have the relevant stakeholder groups been consulted in producing the outline business case?		OGC Gateway 1, p5, 1.5

d) There is good quality project management

Indicators	Further questions	Further guidance
Have governance structures for the project procurement been set up?		OGC Gateway 0, p7, 1.3
Has a realistic project procurement timetable been laid out?		OGC Gateway 1, p5 1.1, p11 4.5
Has a well resourced and experienced project team been put in place for the procurement?	<p data-bbox="427 672 785 725">Do the project team members have the relevant skills?</p> <ul style="list-style-type: none"> <li data-bbox="427 743 839 797">■ Is there appropriate legal, technical and financial expertise? <li data-bbox="427 815 772 869">■ Is there appropriate procurement expertise? <p data-bbox="427 887 855 940">Has the project team been assembled in good time?</p> <p data-bbox="427 958 855 1039">Have adequate procedures been put in place for managing the risk associated with staff changes?</p> <p data-bbox="427 1057 855 1111">Has a sufficient amount of staff resource been allocated to the project?</p> <p data-bbox="427 1128 855 1182">Has the authority incorporated lessons learnt from previous procurements?</p>	<p data-bbox="895 672 1158 698">OGC Gateway 1, p11, 4.4</p> <p data-bbox="895 743 1347 770">PFI: Meeting the Investment Challenge, p9, 1.35</p> <p data-bbox="895 815 1098 842">ibid., p96, 8.10-8.11</p> <p data-bbox="895 887 1257 913">OGC Gateway 1, p11, 4.4; p12, 4.6</p> <p data-bbox="895 958 1037 985">ibid., p11, 4.4</p> <p data-bbox="895 1057 938 1084">Ibid.</p> <p data-bbox="895 1128 1104 1155">Green Book, p5, 2.12</p>
Has the form of staff and user consultation required for the procurement been identified?		OGC Gateway 3, p6, 1.9
Has the senior management input required for a successful procurement been identified?		OGC Gateway 0, p7, 1.3-1.4; OGC Gateway 1, p6, 1.10

e) There is an optimal balance between cost, quality and flexibility

Indicators	Further questions	Further guidance
Have market soundings been taken to generate maximum competition?		VFM Assessment Guidance, p25, 5.10
Is the Authority confident that the specification for the project will be affordable?		VFM Assessment Guidance, p4, 1.8
Has the optimal balance of the proposed project not been compromised by favourable accounting treatment for the Authority?		VFM Assessment Guidance, p3, 1.3 PFI: Meeting the Investment Challenge, p24, 2.26

f) Effective risk allocation and management is taking place

Indicators	Further questions	Further guidance
Has the project risk been fully assessed?	Have the risks associated with the project been identified? Is the proposed risk allocation sensible?	PFI: Meeting the Investment Challenge, p114, A4
Are procurement risks being managed well?	Have the risks with proceeding with the project been identified? Has a mitigating risk management plan been put in place and been followed?	OGC Gateway 1, p9, 3.1-3.2

2 Tendering

a) The project fits with the business requirements of the Authority

Indicators	Further Questions	Further Guidance
Do the output specifications in the tender properly address the business requirements?	<p>Is the specification detail properly focused on outputs rather than inputs?</p> <p>Is the specification consistent with the expected project deliverables?</p> <p>Were Authority staff appropriately involved in the identification of requirements?</p> <p>Are the output specifications clearly communicated to bidders in the Tendering documents?</p> <p>Did the Authority discuss their requirements with prospective bidders to ensure that they were practical?</p>	<p>PFI: Meeting the Investment Challenge, p33, 3.24</p> <p>VFM Assessment Guidance, p21, Table 5.1</p> <p>PFI: Meeting the Investment Challenge, p33, 3.23</p> <p>OGC Gateway 2, p6, 2.3</p> <p>VFM Assessment Guidance, p25, 5.10</p>
Have robust payment and performance measurement mechanisms been put in place that clearly reflect optimal business requirements?	<p>Is a robust performance-measurement regime proposed?</p> <ul style="list-style-type: none"> ■ Are performance measures well defined and objective? ■ Is there an efficient division of responsibility for monitoring performance proposed? <p>Is there a robust payment regime proposed?</p> <ul style="list-style-type: none"> ■ Does the proposed regime encourage the contractor to deliver the service to the level expected? ■ Is payment dependent on satisfactory delivery of the required services? ■ Are payment deductions proposed for poor delivery of services? ■ Is the payment regime calibrated to focus on the most critical aspects of service delivery? 	<p>OGC Gateway 2, p8, 2.8</p> <p>Standardisation of PFI Contracts (version 3), p70, 9.3.2; p72, 9.6.1-9.6.4</p> <p>Standardisation of PFI Contracts (version 3), P77, 10.1.1</p> <p>PFI: Meeting the Investment Challenge, p39, 3.46</p> <p>Standardisation of PFI Contracts (version 3), p77, 10.2.1, bullet 4</p> <p>ibid., p75, 9.11.2</p>
Is the Authority clear about its approach on balancing flexibility for change against price?	<p>Do the tender documents include proposed procedures for introducing changes to the Authority's requirements?</p> <p>Has the Authority decided what would be an acceptable cost trade-off for long-term operational flexibility?</p>	<p>Treasury Taskforce Technical Note 6, p5, 2.4.2</p> <p>VFM Assessment Guidance, p22, Table 5.1, 'Operational Flexibility'</p>

b) PFI is the appropriate delivery mechanism

Indicators	Further questions	Further guidance
Has the Authority encouraged the private sector to put forward innovative solutions?	Design Variants?	
	Operational Process Variants?	PFI: Meeting the Investment Challenge, p32, 3.15, Bullet 2
	Financing Variants?	Ibid., p106, 9.6
	Output Variants?	ibid., p69, Box, Bullet 4
	Risk Transfer Variants?	Standardisation of PFI Contracts (version 3), p69, 9.2.1 PFI: Meeting the Investment Challenge, p2, 1.8 Standardisation of PFI Contracts (version 3), p65, 8.1.2; p69, 9.2.1
Has the Authority checked that the justification for a PFI solution as contained in the business case still holds?		VFM Assessment Guidance, p17, 4.2, Bullet 1

c) Stakeholders support the project's progress

Indicators	Further questions	Further guidance
Have all key stakeholders maintained commitment to the project?		OGC Gateway 1, p5, 1.5
		OGC Gateway 0, p7, 1.3
		OGC Gateway 3, p6, 1.9

d) There is good quality project management

Indicators	Further questions	Further guidance
Has a good project team been maintained for the tendering phase?	Is there access to sufficient expertise when required?	PFI: Meeting the Investment Challenge, p9, 1.35
	Are there team members with good negotiating skills?	PFI: Meeting the Investment Challenge, p97, 8.13, bullet 3
Has a clear and realistic procurement timetable for tendering been put in place and maintained?		OGC Gateway 1, p11, 4.5
		OGC Gateway 2, p12, 5.2
Have likely contract issues been identified before the start of tendering?		Green Book, p9, 2.25

Indicators (continued)	Further questions (continued)	Further guidance (continued)
Have procurement costs been controlled?	<p>Have advisers been appointed after competition?</p> <p>Have realistic budgets been set and updated where appropriate?</p> <p>Have costs been monitored and managed?</p>	<p>PFI: Meeting the Investment Challenge, p99, 8.22</p> <p>OGC Gateway 2, p10, 3.1-3.2</p> <p>ibid., p10, 3.1</p>
Has a clear process for evaluating bids and setting assessment criteria been put in place?	<p>Have clear assessment criteria been set in advance of tendering and communicated to bidders?</p> <p>Is the weighting of evaluation criteria in line with business objectives?</p> <p>Have specialist sub-groups been set up to evaluate the different components of the bids, e.g. financial, quality of service, financial stability of bidders, risk transfer and design quality?</p> <p>Has the importance of relationships and partnership working been incorporated as an assessment criterion?</p> <p>Is the decision-making process transparent?</p> <p>Are clear guidelines for liaising with bidders drawn up?</p>	<p>Treasury Taskforce Technical Note 4, p5, 3.1.1</p> <p>OGC Gateway 2, p9, 2.12, bullet 2</p> <p>ibid., bullet 3</p> <p>OGC Gateway 3, p11, 5.1</p> <p>OGC Gateway 0, p5, last bullet; OGC Gateway 2, p8, 2.8</p>
Is the Authority clear about the governance arrangements for the project once it is operational?		PFI: Meeting the Investment Challenge, p3, 1.10

e) There is an optimal balance between cost, quality and flexibility

Indicators	Further questions	Further guidance
Have quality bids addressing core business requirements been received?		<p>OGC Gateway 3, p7, 2.1</p> <p>PFI: Meeting the Investment Challenge, p81, 7.14</p>
Has the economically most advantageous bid been selected?	<p>Is the cost of the bid affordable?</p> <p>Does the winning bidder have a good track record?</p> <p>Is the proposed design suitable for business requirements?</p> <p>Are the proposed operational solutions suitable for business requirements?</p> <p>Is VFM being achieved without workers' terms and conditions being degraded?</p>	<p>VFM Assessment Guidance, p18, 4.8</p> <p>OGC Gateway 2, p8, 2.9, Bullet 3</p> <p>OGC Gateway 3, p7, 2.1, 2.3</p> <p>PFI: Meeting the Investment Challenge, p97, Box 8.1</p> <p>OGC Gateway 3, p7, 2.1, 2.3</p> <p>PFI: Meeting the Investment Challenge, p69, 6.1</p>

f) Effective risk allocation and management is taking place

Indicators	Further questions	Further guidance
Is the risk best managed by the private sector being transferred as part of the proposed contract?		PFI: Meeting the Investment Challenge, p35, 3.29; p66, 5.30, Bullet 2
Are the procedures for managing procurement risk working and being updated where applicable?		OGC Gateway 2, p11, 4.1-4.2 OGC Gateway 3, p10, 4.1-4.5

3 Contract Completion

a) The project fits with the business requirements of the Authority

Indicators	Further questions	Further guidance
Has the project strategy and likely outcome been re-evaluated to ensure they are still in line with business needs?	Are the original objectives for the project still valid? Does the proposed deal fit with the latest circumstances?	OGC Gateway 3, p5, 1.1 Treasury Taskforce Technical Note 4, p3, 2.2.6
Does the contract reflect the Authority's business requirements?	Does the contract reflect the deal that has been negotiated? Are handover/termination arrangements clearly specified? Are there appropriate sanctions/bonuses to incentivise the contractor? Are the performance measures in line with the business requirements? Are there appropriate provisions for dealing with changing requirements?	Treasury Taskforce Technical Note 4, p3, 2.2.3 Standardisation of PFI contracts (version 3), p123, 18.1.2; p128, 19.4.1-19.4.4 ibid., p38, 4.6.1-4.6.4; p77, 10.2.1; p78, 10.3.1-10.3.4 ibid., p69, 9.2.1 ibid., p83, 12.1.1, 12.2.2

b) PFI is the appropriate delivery mechanism

Indicators	Further questions	Further guidance
Was a review carried out to confirm that alternatives were evaluated and fairly eliminated?	Were all reasonable alternatives examined if there was doubt about the value for money of the PFI deal? Was there a clear overview confirming the desirability of proceeding with the best deal?	VFM Assessment Guidance, p17, 4.1 OGC Gateway 1, p6, 1.11

c) Stakeholders support the project's progress

Indicators	Further questions	Further guidance
Do key stakeholders support the agreed deal?		OGC Gateway 3, p6, 1.9

d) There is good quality project management

Indicators	Further questions	Further guidance
Has good procurement management been exercised during the preferred bidder stage?	Have the differences between the winning bid and contract award been limited?	Treasury Taskforce Technical Note 4, p12, 5.15
	Were delays in getting to contract close kept to a minimum?	ibid., p7, 4.3.1-4.3.3
	Have outstanding issues at contract close been kept to a minimum?	ibid.
Are there appropriate contract-management arrangements in place?	Have responsibilities for monitoring the contract been established?	Standardisation of PFI contracts (version 3), p70, 9.3.1-9.3.2
	Has the Authority ensured that key staff monitoring the contract have the required knowledge and skills?	OGC Gateway 4, p10, 4.3 OGC Gateway 4, p10, 4.3, bullet 2
	Are there appropriate arrangements for feedback from Authority staff interfacing with the project?	Treasury Taskforce Technical Note 6, p4, 2.3.6-2.3.7
	Are there appropriate processes for resolving day-to-day operational issues?	ibid., p8, 3.1.4; p9, 3.1.6 Bullet 13

e) There is an optimal balance between cost, quality and flexibility

Indicators	Further questions	Further guidance
Is the deal affordable in the short and long term?	Are there firmly secured sources of funds for any capital injections into the project by the Authority?	VFM Assessment Guidance, p21, 5.2
	Are there firmly secured sources of funds for ongoing payments?	OGC Gateway 0, p10, 2.7
Has competitive financing been achieved?	Has a financing competition been held?	VFM Assessment Guidance, p36, 7.15 PFI: Meeting the Investment Challenge, p106, 9.2, Bullet 1,
	Has the optimal finance structure been achieved?	PFI: Meeting the Investment Challenge, pp106-107, 9.6-9.8

Indicators (continued)	Further questions (continued)	Further guidance (continued)
Is the final agreed deal the economically most advantageous solution?	<p>Has the asset design been assessed as being optimal for users?</p> <p>Have the service specifications been assessed as what is required by service users?</p>	<p>Treasury Taskforce Technical Note 7, p3, 2.3</p> <p>VFM Assessment Guidance, p3, 1.3</p> <p>OGC Gateway 3, p7, 2.3, Bullet 3</p>
Has a review been conducted to ensure that accounting treatment has not compromised the deal's optimal balance?	Have the benefits and costs of the proposed asset and services been quantified?	<p>VFM Assessment Guidance, p6, 1.13</p> <p>PFI: Meeting the Investment Challenge, p24, 2.26; p25, 2.27; p121, B24</p>

f) Effective risk allocation and management is taking place

Indicators	Further questions	Further guidance
Has the final agreed risk transfer contained in the contract been reviewed for appropriateness?		<p>PFI: Meeting the Investment Challenge, p35, 3.30-3.31</p> <p>OGC Gateway 3, p10, 4.4</p>
Does the Authority have a risk-management plan for use when the contract goes live?		OGC Gateway 3, p10, 4.1, 4.3

4 Pre-Operational Implementation

a) The project fits with the business requirements of the Authority

Indicators	Further questions	Further guidance
Is the asset being delivered to contractual specification?	<p>Is the asset being delivered to time?</p> <p>Is the asset being delivered to quality?</p> <p>Is there any increase in the unitary payment?</p>	<p>Treasury Taskforce Technical Note 6, p18, 4.3.4</p> <p>ibid., p20, boxed example (bottom of page)</p> <p>ibid., p20, 4.3.7, Bullet 2</p>

b) PFI is the appropriate delivery mechanism

Indicators	Further questions	Further guidance
Has the baselining of service provision continued?		Standardisation of PFI Contracts (Version 3), p69, 9.2.2

c) Stakeholders support the project's progress

Indicators	Further questions	Further guidance
Have key stakeholders been kept informed of project progress?		OGC Gateway 4, p7, 2.3

d) There is good quality project management

Indicators	Further questions	Further guidance
Has a good post-procurement evaluation been carried out?	Has the evaluation considered if the staffing of the procurement was appropriate?	Treasury Taskforce Technical Note 6, p17, 4.2.3
	Was there evaluation of the use of external advisers?	Treasury Taskforce Technical Note 3, p12, 4.5.7
	Was there effective planning and management of the procurement?	OGC Gateway 5, p10, 6.2
	Has the evaluation identified deficiencies in the contract that need to be resolved?	OGC Gateway 5, p5, 2.3.
	Have the lessons from such an evaluation been disseminated for wider learning?	Green Book, p47, 7.17-7.18
Are all outstanding issues from contract close resolved?	Has a clear timetable for resolving such issues been produced?	OGC Gateway 4, p7, 2.2, Bullet 6
	Has a clear project-management process been put in place for ensuring the issues are resolved?	ibid.
Is there provision for effective oversight and resolution of material problems arising?	Has a process been agreed between the Authority and the contractor for resolving problems?	Treasury Taskforce Technical Note 6, p9, 3.1.6, Bullet 13
	Are the appropriate levels of management staff committed to resolution procedures?	ibid., p19, 4.3.7, Bullet 3; p20, 4.3.7, Bullet 1, Example 2
	Does the Authority have a fall-back plan in place if there is a delay to the asset becoming operational?	ibid., p9, 3.1.6, Bullet 14
Are systems developed to deal with the new asset and service provision?	Has the Authority properly educated its staff on the changes to be expected once the operational phase commences?	ibid., p16, 3.7.1-3.7.3
	Do both parties have appropriate procedures for managing the handover period?	ibid., p21, 4.4.3, Bullet 2
Are governance arrangements still appropriate?		
Has the correct skills transfer within the public sector taken place from procurement to operational contract management?	Is there a sensible resource plan to go from delivery to operational phase?	Treasury Taskforce Technical Note 6, p21, 4.4.1
	Has the Authority put in place procedures for transferring knowledge of the contract from the negotiation team to the contract-management team?	ibid., p4, 2.3.2-2.3.3; p17, 4.2.3

e) There is an optimal balance between cost, quality and flexibility

Indicators	Further questions	Further guidance
Do price increases only relate to new priority changes needed by the public sector, which are on terms that are good value for money?		PFI: Meeting the Investment Challenge, p38, 3.40

f) Effective risk allocation and management is taking place

Indicators	Further questions	Further guidance
Are risk-mitigation procedures working properly?	Is the risk-management plan being updated regularly?	OGC Gateway 0, p13, 5.1, Bullet 4 OGC Gateway 4, p9, 3.1-3.2

5 Early Operational

a) The project fits with the business requirements of the Authority?

Indicators	Further questions	Further guidance
Is service provision meeting contractual requirements?	<p>Is the performance-measurement system working properly?</p> <ul style="list-style-type: none"> ■ Is the contractor providing timely performance data? ■ Does the PMS cover all services under the contract? ■ In terms of their objectivity, are the performance-measurement criteria acceptable? ■ Does the Authority believe that it is receiving accurate performance data? ■ Are the contractor(s) monitoring performance through a quality-management system? ■ Is the Authority reviewing the contractor's quality-management system? ■ Are there procedures for service users to report failures? <p>Is there a functionally effective payment mechanism?</p> <ul style="list-style-type: none"> ■ Does the payment mechanism cover all relevant aspects of the Authority's business? ■ Does the payment reflect the level of service available? 	<p>Treasury Taskforce Technical Note 6, p12, 3.2.10</p> <p>Standardisation of PFI Contracts (Version 3), p70, 9.3.1</p> <p>ibid., p73, 9.8.1</p> <p>Treasury Taskforce Technical Note 6, p11, 3.2.4; p12, 3.2.10</p> <p>ibid., p11, 3.2.3</p> <p>ibid., p11, 3.2.4</p> <p>ibid., pp 4-5, 2.3.6-2.3.7</p> <p>Standardisation of PFI Contracts (Version 3), p77, 10.1.1</p> <p>ibid., p77, 10.2.1, Bullet 3</p>

Indicators (continued)	Further questions (continued)	Further guidance (continued)
	<ul style="list-style-type: none"> ■ Does the payment mechanism seek to make deductions for substandard performance? ■ Has the Authority reviewed the impact and appropriateness of contractual incentives? 	<p>ibid., p77, 10.2.1, Bullet 4</p> <p>ibid., pp79-80, 10.4.1-10.4.4</p>
Is the asset fit for purpose?	<p>Have construction problems been resolved on a timely basis?</p> <p>Is good maintenance of the asset being carried out?</p>	<p>Treasury Taskforce Technical Note 6, p19-21</p> <p>PFI: Meeting the Investment Challenge, p34, 3.28, Bullet 2;</p> <p>Treasury Taskforce Technical Note 6, p22, 4.4.3, Bullet 7</p>
Where contractual services differ from business requirements, is the Authority acting to align them?	<p>Has the Authority assessed whether the service levels contained in the contract meet the business requirements?</p> <p>Has the Authority taken steps to resolve the discrepancy?</p>	<p>OGC Gateway 3, p7, 2.3, Bullet 3</p> <p>ibid., p2.4-2.7</p>

b) PFI is the appropriate delivery mechanism

Indicators	Further questions	Further guidance
In the event of poor construction outturn, is the Authority sure that maintaining the PFI route for future service provision is the best value for money?	<p>Has the Authority considered termination where poor construction performance has occurred?</p> <p>Has the cost of termination been evaluated?</p> <p>Are alternative service-delivery mechanisms realistic?</p>	<p>Treasury Taskforce Technical Note 6, pp9-10, 3.1.6, Bullet 14</p> <p>Standardisation of PFI Contracts (Version 3), p123, 18.1.2</p> <p>Treasury Taskforce Technical Note 6, pp9-10, 3.1.6, Bullet 14</p>

c) Stakeholders support the project's progress

Indicators	Further questions	Further guidance
Is there a good level of stakeholder satisfaction?	<p>Has the Authority canvassed and measured stakeholders' satisfaction with contractor performance?</p> <ul style="list-style-type: none"> ■ Has the Authority taken steps to address concerns raised by stakeholders? <p>Are end-users satisfied with the level of service from contractors?</p>	<p>OGC Gateway 4, p7, 2.3</p> <p>OGC Gateway 5, p5, 2.1, Bullet 6</p>

d) There is good quality project management

Indicators	Further questions	Further guidance
Are the governance structures being used appropriately?	<p>Are minor problems and issues being addressed and resolved on a timely basis?</p> <p>Are strategic issues and major service-related problems and disputes within the remit of the top tier of the governance arrangements?</p>	<p>Treasury Taskforce Technical Note 6, p8, 3.1.4</p> <p>ibid., p8, 3.1.6, Bullet 13; p16, 3.8.1-3.8.2</p>
Are the relationships between the Authority and contractors working well?	<p>Are relationships between both parties satisfactory at senior-management level?</p> <ul style="list-style-type: none"> ■ Is the contractor kept abreast of the Authority's strategic direction? ■ Is there an open and honest environment between the contractor and the Authority? ■ Have both parties developed a single business focus for the project? <p>Are the appropriate relationships in place at the operational level between Authority and contractor staff?</p> <ul style="list-style-type: none"> ■ Do PFI company staff have an appropriate understanding of the Authority's business? ■ Are relationships being facilitated by co-location of services? ■ Are Authority staff able to easily contact the relevant individuals from the PFI company to discuss issues? 	<p>OGC Gateway 0, p10, 2.5</p> <p>Treasury Taskforce Technical Note 6, p10, 3.1.8</p> <p>PFI: Meeting the Investment Challenge, p40, 3.56</p> <p>Treasury Taskforce Technical Note 6, p13, 3.4.4</p> <p>ibid., p8, 3.1.4</p> <p>Treasury Taskforce Technical Note 6, p8, 3.1.4</p>
Does the Authority ensure that the project team have appropriate skills and knowledge for good service provision?	<p>Do contract-management staff have a detailed knowledge of the contract?</p> <ul style="list-style-type: none"> ■ Do contract-management staff understand their roles and responsibilities? ■ Is there a contract-management manual? <p>Does the Authority have a process of continual learning?</p> <ul style="list-style-type: none"> ■ Is the Authority regularly evaluating the performance of the contract-management team? ■ Does the Authority make use of external consultants where appropriate? ■ Does the Authority seek to learn from the experience of other PFI projects and other Authorities? <p>Does the Authority have appropriate procedures to deal with loss of staff and knowledge?</p>	<p>OGC Gateway 4, p10, 4.3</p> <p>Treasury Taskforce Technical Note 6, p8, 3.1.5; p25, 4.6.1-4.6.2</p> <p>OGC Gateway 5, p5, 2.4, Bullet 3</p> <p>Treasury Taskforce Technical Note 6, p15, 3.6.2</p> <p>PFI: Meeting the Investment Challenge, p94, 8.5</p> <p>OGC Gateway 4, p10, 4.3, Bullet 2</p>

e) There is an optimal balance between cost, quality and flexibility

Indicators	Further questions	Further guidance
Is affordability for the deal being maintained?	Are both parties working together to identify cost reductions?	Standardisation of PFI Contracts (Version 3), p91, 12.6.1
	Has a refinancing, with a relevant share of gains, taken place where possible?	ibid., p253, 35.1, Bullets 1,3
	Has the Authority established the process and timing of future benchmarking exercises?	ibid., pp108-109, 14.4.3
Are both parties seeking to maximise quality?	Are innovations in service delivery taking place?	PFI: Meeting the Investment Challenge, p32, 3.15, Bullet 2
	Are both parties benefiting from two-way working for suggesting improvements to each other's business?	Treasury Taskforce Technical Note 6, p7, 2.5.5
	Do both parties have a process of continual learning and development in place?	OGC Gateway 5, p10, 6.1-6.3
	Are contractors improving the quality of service where specific failures have been identified?	Standardisation of PFI Contracts (version 3), p75, 9.11.4

f) Effective risk allocation and management is taking place

Indicators	Further questions	Further guidance
Has the allocation of risks been sustained operationally?		Treasury Taskforce Technical Note 6, p8, 3.1.2
Are the risk implications of changes to the contract consistent with the risk that was originally transferred?		ibid., p6, 2.4.5-2.4.6
Are the Authority's risk-management procedures updated and working in line with changing circumstances?		Treasury Taskforce Technical Note 6, p5, 2.4.2

6 Mature Operational

a) The project fits with the business requirements of the Authority

Indicators	Further questions	Further guidance
Is service provision outturn meeting core business requirements?	<p>Has the Authority identified where contractual service levels do not meet business requirements?</p> <p>Has the Authority taken steps to rectify the difference between business operational requirements and performance levels?</p> <p>(a) Are the standards of service provision in the contract being updated to reflect core business requirements?</p> <p>(b) Is subsequent service provision meeting the revised SLA?</p> <ul style="list-style-type: none"> ■ Does the Authority ensure that the information generated by the performance-monitoring system is consistent with any update or change to the contract? ■ Is the contractor meeting revised service requirements? ■ Is the Authority reviewing the impact and appropriateness of the revised contractual incentives? 	<p>PFI Meeting the Investment Challenge, p104, 8.45-8.46</p> <p>PFI: Meeting the Investment Challenge, p38, 3.40</p> <p>OGC Gateway 5, p5, 2.1, Bullets 1,2</p> <p>ibid.</p>
Is the asset still fit for purpose and maintained to a good standard?	<p>Is the asset in a fit state for use?</p> <p>Has the asset's fitness for purpose been assessed?</p> <p>Are maintenance schedules being adhered to?</p> <p>Is the Authority checking that the SPV's maintenance reserves are being managed to ensure sufficient monies are available for asset replacement and maintenance?</p>	<p>Treasury Taskforce Technical Note 6, p22, 4.4.3, Bullet 7</p> <p>ibid.</p> <p>ibid.</p> <p>PFI: Meeting the Investment Challenge, p32, 3.14, Bullet 4; p34, 3.28, Bullet 2</p>

b) PFI is the appropriate delivery mechanism

Indicators	Further questions	Further guidance
Has the Authority improved its performance since the PFI project became operational?	<p>Has service provision (both PFI-delivered and that retained in-house) been compared to the previously baselined service provision?</p> <p>Have the outcomes identified as PFI-specific in the business case been realised?</p> <p>Has the PFI asset's design outcome been assessed in a qualitative comparison with equivalent non-PFI assets?</p>	<p>Standardisation of PFI Contracts (Version 3), p69, 9.2.2</p> <p>OGC Gateway 5, p7, 4.2, Bullet 1</p> <p>Treasury Taskforce Technical Note 7, pp3-7, 2.4-2.5</p>
Has the Authority assessed whether maintaining the PFI deal for future service provision is the best value for money?	<p>Has the Authority considered termination where poor performance is occurring?</p> <p>Has the cost of termination been evaluated?</p> <p>Are alternative service-delivery mechanisms realistic?</p>	<p>Standardisation of PFI Contracts (Version 3), p139, 20.2.1.1</p> <p>ibid., p123, 18.1.2</p> <p>Treasury Taskforce Technical Note 6, p9, 3.1.6, last bullet</p>

c) Stakeholders support the project's progress

Indicators	Further questions	Further guidance
Is a good level of stakeholder satisfaction being maintained?	<p>Is the Authority periodically canvassing stakeholders for their views on the how the asset and associated services are performing?</p> <p>Is the Authority taking steps to address concerns raised by stakeholders?</p> <p>Is there ongoing end-user satisfaction with the level of service from contractors?</p>	<p>OGC Gateway 4, p5, 1.2; p7, 2..3</p> <p>OGC Gateway 5, p5, 2.1, Bullet 6</p> <p>OGC Gateway 5, p4, 1.4</p> <p>OGC Gateway 5, p5, 2.1, Bullet 6</p>

d) There is good quality project management

Indicators	Further questions	Further guidance
Are the governance arrangements still appropriate?	<p>Have governance structures been reviewed and updated with changing circumstances?</p> <p>Are disputes over service provision being resolved at the appropriate management levels?</p> <ul style="list-style-type: none"> ■ Are minor problems and issues being addressed and resolved by the lower tiers within the governance structure? ■ Is the Authority using the top tier of the governance structure to discuss contract change, service improvement, business development and strategic direction, and to resolve major problems and disputes? 	<p>Treasury Taskforce Technical Note 6, p5, 2.3.10; p8, 3.1.3; p9 3.1.6, Bullet 12; p13, 3.4.3</p> <p>Treasury Taskforce Technical Note 6, p8, 3.1.4</p> <p>OGC Gateway 5, p4, 1.3; p5, 2.1, Bullet 1, 2.3, 2.5; p6, 3.1</p>
Are good and constructive relationships between both parties being maintained?	<p>Are relationships between both parties satisfactory at senior management level?</p> <ul style="list-style-type: none"> ■ Are the appropriate relationships being created according to changing circumstances? ■ Is the contractor consulted over the Authority's strategic direction? ■ Is there an open and honest environment between the contractor and the Authority? ■ Is a single business focus for the project being maintained by both parties? <p>Are the appropriate relationships in place at the operational level between the Authority and contractor staff?</p> <ul style="list-style-type: none"> ■ Does the PFI company staff have an appropriate understanding of the Authority's business? ■ Are relationships being facilitated by co-location of services? ■ Is the Authority able to easily contact the relevant individuals from the PFI company to discuss issues? 	<p>Treasury Taskforce Technical Note 6, p8, 3.1.3</p> <p>OGC Gateway 0, p10, 2.5, Bullet 2</p> <p>Treasury Taskforce Technical Note 6, p10, 3.1.8</p> <p>PFI: Meeting the Investment Challenge, p40, 3.56</p> <p>Treasury Taskforce Technical Note 6, p13, 3.4.4</p> <p>ibid., p8, 3.1.4</p> <p>ibid., p8, 3.1.4</p>

Indicators (continued)	Further questions (continued)	Further guidance (continued)
Is the Authority taking steps to ensure that the project team continue to have the appropriate skills and knowledge for good service provision?	<p>Is the Authority re-evaluating skills sets for the management of the project to ensure appropriate staff are in post?</p> <p>Do contract-management staff have a detailed knowledge of the contract?</p> <ul style="list-style-type: none"> ■ Do contract-management staff understand their roles and responsibilities? ■ Is the contract-management manual being updated? <p>Does the Authority have a process of continual learning?</p> <ul style="list-style-type: none"> ■ Does the Authority regularly evaluate the performance of the contract-management team? ■ Does the Authority make use of external consultants where appropriate? ■ Does the Authority seek to learn from the experience of other PFI projects and other Authorities? ■ Does the Authority have appropriate procedures to deal with loss of staff and knowledge? 	<p>Treasury Taskforce Technical Note 6, p12, 3.4.1</p> <p>OGC Gateway 4, p10, 4.3, Bullet 3</p> <p>Treasury Taskforce Technical Note 6, p8, 3.1.5; p25, 4.6.1-4.6.2</p> <p>OGC Gateway 5, p5, 2.4, Bullet 3</p> <p>Treasury Taskforce Technical Note 6, p15, 3.6.2</p> <p>PFI: Meeting the Investment Challenge, p94, 8.5</p> <p>OGC Gateway 4, p10, 4.3, Bullet 2</p>
Has the Authority taken steps to plan for the end of the contract?	<p>Has the Authority identified how services will be provided once the contract finishes?</p> <p>Has the Authority identified the risks associated with the handover of the asset at the end of the contract?</p>	<p>PFI: Meeting the Investment Challenge, p121, B23</p>

e) There is an optimal balance between cost, quality and flexibility

Indicators	Further questions	Further guidance
Is affordability being maintained?	Are both parties actively seeking cost reductions? Is the Authority ensuring that the cost of changes to service provision are reasonable?	Standardisation of PFI Contracts (Version 3), p91, 12.6.1 ibid., pp91-92, 12.6.1-12.6.2
Are both parties seeking to maximise quality?	Are innovations in service delivery taking place? Are both parties benefiting from two-way working for suggesting improvements to each other's business? Do both parties have in place a process of continual learning and development? Are contractors improving the quality of service where specific failures have been identified?	PFI: Meeting the Investment Challenge, p32, 3.15, Bullet 2 Treasury Taskforce Technical Note 6, p7, 2.5.5 OGC Gateway 5, p10, 6.1-6.3 Standardisation of PFI Contracts (Version 3), p75, 9.11.4
Is periodic benchmarking for price and quality taking place?	Have appropriate benchmarks been identified? Is the period of time between benchmarking exercises appropriate?	ibid., p108, 14.4.2 ibid., pp107-108, 14.3.6; 14.4.3, Bullets 1-2

f) Effective risk allocation and management is taking place

Indicators	Further questions	Further guidance
Is the Authority satisfied that the risk transferred remains optimal?	Is the risk deemed as being transferred to the contractors consistent with the risk that is being borne by the contractor in practice? Has the formal allocation of risks been reviewed? Are the risk implications of changes to the contract consistent with optimal allocation of risk?	Treasury Taskforce Technical Note 6, p8, 3.1.2 ibid., p6, 2.4.6 ibid., p6, 2.4.5-2.4.6
Are the Authority's risk-management procedures updated and working in line with changing circumstances?		ibid., p5, 2.4.2
Does the accounting treatment for the asset remain consistent with the actual risk that has been transferred to the private sector?		PFI: Meeting the Investment Challenge, p25, 2.27; p121, B24

List of Sources for Further Guidance

The following guidance is issued by HM Treasury and can be accessed via the website addresses given. Copies of guidance can also be obtained via The Stationery Office.

Green Book – Appraisal and Evaluation in Central Government, 2003

http://www.hm-treasury.gov.uk./media/785/27/Green_Book_03.pdf

PFI: Meeting the Investment Challenge, 2003

http://www.hm-treasury.gov.uk./media//648B2/PFI_604.pdf

PFI: Strengthening Long Term Partnerships, 2006

http://www.hm-treasury.gov.uk/media/1E1/33/bud06_pfi_618.pdf

Standardisation of PFI Contracts (Version 3), 2004

http://www.hm-treasury.gov.uk./media/B42/D9/pfi_sopc_ver3_complete_apr04.pdf

Treasury Taskforce Technical Note 3 – How to Appoint and Manage Advisers to PFI Projects

http://www.hm-treasury.gov.uk/media/E54/0F/PPP_TTF_Technote3.pdf

Treasury Taskforce Technical Note 4 - How to Appoint and Work with a Preferred Bidder

<http://www.hm-treasury.gov.uk/media/ADC/F1/ACFBEE.pdf>

Treasury Taskforce Technical Note 6 - How to Manage the Delivery of Long Term PFI Contracts

http://www.hm-treasury.gov.uk/media/B777C/PPP_TTF_Technote6.pdf

Treasury Taskforce Technical Note 7 - How to Achieve Design Quality in PFI Projects

http://www.hm-treasury.gov.uk/media/06C/5A/PPP_TTF_Technote7.pdf

Value for Money Assessment Guidance, 2004

<http://www.hm-treasury.gov.uk/media/95C/76/95C76F05-BCDC-D4B3-15DFDC2502B56ADC.pdf>

The Office of Government Commerce Gateway Process Guidance can be found at <http://www.ogc.gov.uk/index.asp?id=1000840>

In the tables above, OGC Gateway 2, for instance, would refer to the guidance link for the second stage of the Gateway Process.

ANNEX 2

Glossary

Term	Definition
Authority	A public sector body which lets a PFI contract. This may be a government department, an agency of a department or, in the case of the health sector, a National Health Service trust.
Benchmarking	The process of comparing the time or cost of an operation service or product against those of other organisations, preferably thought to be the best in the field.
Baseline Service Provision	We use this phrase to signify the level of service provision in place prior to the PFI contract being awarded.
Conventionally financed	A construction contract in which the customer pays the contractor as the works are progressed. Such projects are fully paid for on completion. Maintenance is dealt with in separate contracts.
Customer	The public sector body that will award the contract. Not necessarily a government department: might be an NHS Trust, local authority etc.
Outline Business Case	A document which sets out the reasons why a project should be developed.
Performance Measurement System	A system to measure the contractor's performance against specified criteria. Deductions from payments to the contractor can be made if performance falls below set levels.
Preferred bidder	A bidder selected from the shortlist to carry out exclusive negotiations with the Authority.
Private Finance Initiative	A policy introduced by the Government in 1992 to harness private sector management and expertise in the delivery of public services.
Public Sector Comparator	An estimate of what the project would cost if traditional procurement methods were used. This is used to determine whether private finance offers better value for money than traditional procurement .
Risk transfer	The passing of risk normally borne by the customer to the service provider.
Service Level Agreement	An agreement between the Authority and the contractor detailing the level of performance to be provided for a specified service
Traditional procurement	See conventionally financed .
TUPE	The Transfer of Undertakings (Protection of Employment) Regulations 1981, which aim to safeguard the rights of employees on their transfer to another employer, for example when their work is contracted out.
Unitary payment	The periodic payment that the public sector agrees to pay for the provision of services by the PFI contractor.
Value for Money (VFM)	The achievement of the optimum combination of whole life cost and quality to meet the customer's requirements.

