



House of Commons
Committee of Public Accounts

Transforming contract management

Twenty-third Report of Session 2014–15

*Report, together with the formal minutes
relating to the report*

*Ordered by the House of Commons
to be printed 26 November 2014*

HC 585
[Incorporating HC 586]
Published on 10 December 2014
by authority of the House of Commons
London: The Stationery Office Limited
£0.00

Committee of Public Accounts

The Committee of Public Accounts is appointed by the House of Commons to examine "the accounts showing the appropriation of the sums granted by Parliament to meet the public expenditure, and of such other accounts laid before Parliament as the committee may think fit" (Standing Order No 148).

Current membership

[Rt Hon Margaret Hodge](#) (*Labour, Barking*) (Chair)
[Mr Richard Bacon](#) (*Conservative, South Norfolk*)
[Guto Bebb](#) (*Conservative, Aberconwy*)
[Mr David Burrowes](#) (*Conservative, Enfield, Southgate*)
[Jackie Doyle-Price](#) (*Conservative, Thurrock*)
[Chris Heaton-Harris](#) (*Conservative, Daventry*)
[Meg Hillier](#) (*Labour, Hackney South and Shoreditch*)
[Mr Stewart Jackson](#) (*Conservative, Peterborough*)
[Andrea Leadsom](#) (*Conservative, South Northamptonshire*)
[Rt Hon Anne McGuire](#) (*Labour, Stirling*)
[Austin Mitchell](#) (*Labour, Great Grimsby*)
[Stephen Phillips QC](#) (*Conservative, Sleaford and North Hykeham*)
[John Pugh](#) (*Liberal Democrats, Southport*)
[Nick Smith](#) (*Labour, Blaenau Gwent*)

Powers

Powers of the Committee of Public Accounts are set out in House of Commons Standing Orders, principally in SO No 148. These are available on the Internet via www.parliament.uk.

Publications

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the internet at www.parliament.uk/pac. A list of Reports of the Committee in the present Parliament is at the back of this volume. Additional written evidence may be published on the internet only.

Committee staff

The current staff of the Committee is Sarah Petit (Clerk), Claire Cozens (Committee Specialist), James McQuade (Senior Committee Assistant), Sue Alexander and Jamie Mordue (Committee Assistants) and Janet Coull Trisic (Media Officer).

Contacts

All correspondence should be addressed to the Clerk, Committee of Public Accounts, House of Commons, 7 Millbank, London SW1P 3JA. The telephone number for general enquiries is 020 7219 4099; the Committee's email address is pubaccom@parliament.uk

Contents

Report	<i>Page</i>
Summary	3
1 Achieving value for money from contracts	5
Senior management focus on contract management	6
Improving commercial skills in government	7
The response in the Ministry of Justice and the Home Office	8
2 Contractor's duty of care to the taxpayer	10
Incentives and ethical behaviour	10
'Corporate renewal'	11
3 Management of public service markets	13
The consolidation of markets – too important to fail	13
Consequences for failure	14
Opening up public services to SMEs	15
4 Rebalancing power in favour of the taxpayer	17
Monitoring performance	17
Using open book to align incentives	17
Transparency to the public	19
Formal Minutes	24
Witnesses	25
List of printed written evidence	25
List of Reports from the Committee during the current session	26

Summary

The private sector delivers complex services on behalf of the public sector, to the value of around £90 billion, which represents half of public sector expenditure on goods and services. The public needs to have confidence that contracts are managed well by both government departments and the contractors themselves. The case of G4S and Serco overcharging the Ministry of Justice for years on electronic tagging contracts was the starkest illustration of both contractors' failure to work in the public interest and government failure to safeguard taxpayers' money. In the course of our work we have identified and examined similar cases where there are allegations of the misuse of taxpayers' money. In our view the present crisis could have been avoided if earlier recommendations from this Committee had been acted upon.

The electronic tagging case has served as a belated wake up call and, led by the Cabinet Office, the government is now working to improve the way it manages its suppliers and contracted-out providers of public services. But the problems with contracting are widespread, long standing and rooted in the culture of the civil service. There is a long way to go and the focus on improvement must not be allowed to drift away as it has done in the past. In this report we set out four key areas for attention.

First, government will not achieve value for money from its contracts until it pays much more attention to contract management. In essence, the Civil Service has prioritised the work involved in letting contracts and deemed the monitoring of contracts as mechanical and unimportant. Government acknowledges that departments have long neglected to devote enough resource and expertise to the ongoing oversight and monitoring of 'live' contracts; taking their eye off the ball and placing too much trust in contractors and too much reliance on the information contractors supply. Government recognises that contracts have not been managed at a sufficiently senior level and that there has not been enough personal accountability for performance. Indeed, some departments have been cutting staff numbers working on contract management just when the Government has been growing the role of the private sector in delivering public services. It is also trying to tackle the long standing problem of government not having the commercial expertise to compete with their counterparts in the private sector—a difficult battle to win. The recruitment of crown representatives, although at present too many are appointed from within the civil service, and the commercial fast stream programme are moves in the right direction. Strong accountability and appropriate sanctions and rewards for staff managing contracts should become the norm.

Second, contractors have not shown an appropriate duty of care in the use of public funds. Too often the ethical standards of contractors have been found wanting. It seems that some suppliers have lost sight of the fact that they are delivering public services, and that brings with it an expectation to do so in accordance with public service standards. The legitimate pursuit of profit does not justify the illegitimate failure to conduct the business in an ethical manner. A culture of revenue and profit driven performance incentives has too often been misaligned with the needs of the public who fund and depend on these services. In that context it is refreshing to hear contractors now talking about the need for "*a new way of*

thinking about how companies do business with the Government, which is that companies owe a duty of care to the taxpayer". The challenge, for both the contractors and for government departments, is to turn that sentiment into meaningful changes in behaviour.

Third, as public service markets develop, quasi-monopoly suppliers are emerging who squeeze out competition, often from smaller companies with specific experience. Competition for government business should bring with it a constant pressure to innovate and improve. But for competition to be meaningful, there must be real consequences for contractors who fail to deliver and the realistic prospect that other companies can step in. It was not acceptable for Government to give the impression that all business with Serco and G4S was halted whilst investigations took place, when in fact contracts were extended, new contracts were awarded and negotiations for new business continued. Suppliers have become increasingly dominant in certain markets, often through acquisitions, while also failing to maintain effective control over all parts of their business. Government must guard against suppliers becoming too important to fail, and encourage competition through, for example, disaggregating contracts to encourage SMEs to bid for work. It must also make sure that all suppliers have effective internal controls commensurate with their size and responsibilities at simplifying and accelerating the procurement process.

Finally, the way government contracts gives too much advantage to the contractors. Government needs to rebalance commercial relationships towards its own and the taxpayers' interests. For example, long term service contracts need to be let in a way that allows government to manage costs and performance throughout the contract's life, and avoids the taxpayer being locked into unreasonable and out-dated costs and a victim of excessive profits. Government needs to extend its open book access arrangements in order to better understand contractors' performance and costs and ensure that contractors can only increase profits by performing better or cutting the cost to the taxpayer. Contractors also need to accept that spending public money brings with it a greater degree of public scrutiny and transparency; they must be far more open through, for example, the publication of contracts and performance indicators being standard practice.

For this report we took evidence on the basis of two reports by the Comptroller and Auditor General.¹ We took evidence from G4S and Serco, from the Confederation of British Industry, Chair of the Committee on Standards in Public Life, Cabinet Office, Ministry of Justice and Home Office. This report builds further on the report and recommendations we published in March 2014.²

1 [C&AG's report, Home Office and Ministry of Justice, Transforming contract management, HC 268 Session 2013-15, 4 September 2014; C&AG's report, Cabinet Office, Transforming government's contract management, HC 269 Session 2013-15, 4 September 2014](#)

2 [Committee of Public Accounts, Contracting out public services to the private sector, HC 777, Session 2013-14, 14 March 2014](#)

1 Achieving value for money from contracts

1. Conclusion: *The government will not achieve value for money from its contracts until it pays much more attention to contract management.*

2. In 2013, government discovered that G4S and Serco had been overcharging the Ministry of Justice on its electronic monitoring contracts for years. The contracts have since been referred to the Serious Fraud Office along with two other G4S contracts with the Ministry of Justice. A further Ministry of Justice contract with Serco has been referred to the police and all investigations are ongoing. The two companies have since repaid some £180 million. Government described the electronic monitoring experience of 2013 to us as a “wake-up call” for its contract management.³

3. The Government reviews, launched after the discovery of overcharging on electronic monitoring, found widespread evidence of poor contract management across departments. They found weaknesses in many areas, including governance, capability, incentives, performance management and understanding of risk.⁴ These are all areas where, despite this Committee’s recommendations for improvement in 2009, we have seen problems time and again in the evidence brought before us since then.⁵ Despite government’s acceptance of our recommendations in 2009, and the availability of the NAO’s 2008 good practice framework for contract management, the NAO found that government’s focus on improving contract management had since “drifted away”. The NAO also set out the consequences of weaknesses in contract management, which include more scope for fraud and error, more contractual disputes, and a failure to penalise poor performance or achieve cost savings.⁶

4. The NAO reported some positive signs of change with, for example, major spending departments having recently launched significant programmes to improve contract management and the Cabinet Office stepping up its support for departments. But, as the NAO stressed, there is a lot still to be worked out and “*there needs to be widespread change in the culture of the civil service and the way in which contractors are managed.*”⁷

5. It is encouraging that government has now started to take the issue seriously. The Cabinet Office assured us that contract management has moved up the agenda at the top of the civil service. It told us how a senior group chaired by the Cabinet Secretary is overseeing improvement and how the new chief executive of the civil service will also have

3 [AQ 116 \(HC 585\)](#), [BQ 91 \(HC 586\)](#); [C&AG’s report, Transforming government’s contract management, Paragraph 7](#)

4 [C&AG’s report, Transforming government’s contract management, Paragraph 9](#)

5 [Committee of Public Accounts, Central government’s management of service contracts, HC 152, Session 2008-09, 23 March 2009](#); [C&AG’s report, Transforming government’s contract management, Paragraph 2.7, Figure 8](#)

6 [C&AG’s report, Transforming government’s contract management, Paragraphs 10, 11](#)

7 [C&AG’s report, Transforming government’s contract management, Paragraph 20](#)

a role in delivering change.⁸ We also heard how departments such as the Home Office and Ministry of Justice are making significant changes to the way they are managing contracts.⁹

6. Recommendation: *The Cabinet Office must lead efforts to make sure that the current emphasis on improving contract management is embedded across all departments and that tendering processes did not discriminate against small and medium sized enterprises. It must not lose focus and should report back to this Committee by the end of 2015 on the progress made in implementing reforms across government.*

Senior management focus on contract management

7. The Ministry of Justice told us that, during the time of overcharging on electronic monitoring contracts, it had considered that the highest risks were with the negotiation of new contracts, as opposed to the management of ‘live’ contracts. The attention of senior managers in the department was therefore on new contracts and the Ministry acknowledged that “*the energy and effort of people was at a lower level on those live contracts, and that is certainly the lesson that electronic monitoring taught us.*”¹⁰ The NAO report also highlighted how senior governance mechanisms were focused on approving new projects rather than monitoring existing ones, and that senior managers had not taken contract management seriously.¹¹ The Cabinet Office told us that the involvement of senior managers in contract management across government has been patchy. The Cabinet Office also spoke of a culture in the civil service where “*the glamour was in the procurement, and contract management was just handed off to ‘the business’. They all wanted to do the next procurement*”.¹²

8. One of the Cabinet Office’s external crown representatives contrasted this level of engagement with direct accountability in the private sector. He told us that senior managers responsible for strategically important contracts should be “*waking up at 2 a.m. worrying about them*” and that stronger accountability and sanction at senior management level was required.¹³ Both the Home Office and the Ministry of Justice agreed that clear accountability over contracts is important.¹⁴

9. Recommendation: *Accounting Officers remain accountable for spending throughout the life of contracts. They should put in place an accountability framework for contracts which specifies how senior oversight of major contracts should work in practice—including the information needed to scrutinise and challenge contractor performance, cost and progress in making further savings—and the personal responsibilities of senior managers, with appropriate sanctions and rewards for performance.*

8 [BQ 77-78, BQq 93-94](#)

9 [AQ 143-144, C&AG’s report, Home Office and Ministry of Justice, Transforming contract management, Paragraph 11](#)

10 [AQ 125](#)

11 [C&AG report, Transforming government’s contract management, Paragraph 12](#)

12 [BQ 79, 95](#)

13 [BQ 141-143](#)

14 [AQ 222](#)

Improving commercial skills in government

10. The Cabinet Office described a history of deskilling in the civil service, which it believed was a major factor in government's weak contract management.¹⁵ The Ministry of Justice acknowledged it had reduced staff numbers involved in contract management.¹⁶ The Cabinet Office told us how it thought government had too few experienced staff working on contract management and too many at junior levels. They believe this capability is too often focused on the procurement phase than on the management of operational contracts.¹⁷ The NAO report also highlighted the low status of the commercial profession in government and its vulnerability to under-investment.¹⁸

11. We asked the Confederation of British Industry about the apparent asymmetry between the client (government) and contractor, whereby the client does not have comparable knowledge and expertise to deal effectively with contractors on large complex projects. The CBI argued that it is difficult for a government client to have every skill in-house, but that support should be available from other departments or third party advisors. The CBI went on to say *"You have to ask yourselves, if you are going to commission large, complex contracts as part of Government, you need to have the people who can do that and who are paid the right amount of money to do that for you."*¹⁹

12. There are signs that government is beginning to take skills development seriously. We heard about the growing involvement of external crown representatives, who the Cabinet Office told us are bringing private sector commercial experience from which civil service staff can benefit. However at present the Government is too often relying on internal staff from the Civil Service to fulfil the role of external crown representatives. The Cabinet Office also highlighted government's 'commissioning academies', which are providing six days of training for cohorts of civil service staff, and a new commercial fast stream programme to provide graduate careers focussed on commercial activity. But numbers are limited in the context of the step change required.²⁰ We welcome the focus on improving skills in the civil service but fear that the current efforts are not on a scale to address the seriousness of the capability gap. The Comptroller and Auditor General, while recognising the steps being taken to develop skills in government, cautioned against any over-optimistic suggestions that government would ever be able to match and maintain the level of skills and expertise available to the private sector; making the point that this made it all the more important to tilt the balance of contractual relationships back towards the government and taxpayers' interests.²¹

13. The Ministry of Justice and the Home Office both told us about the difficulties they had had recruiting and retaining commercial experts.²² The NAO reported it was doubtful

15 [BQ 54, BQ 95](#)

16 [AQ 143](#)

17 [BQ 71, 95](#)

18 [C&AG's report, Transforming government's contract management, Paragraph 12](#)

19 [BQ 24-27](#)

20 [BQ 58, 59, 66-71](#)

21 [BQ 122](#)

22 [AQ 163](#)

that the capability gap compared to the private sector could ever be closed completely, given the differences in pay and incentives between public and private sector commercial staff.²³ The Cabinet Office agreed that remuneration incentives are not currently sufficient to attract and motivate the best experienced commercial staff.²⁴ The Ministry of Justice drew a contrast with quite different organisational structures in the private sector, with higher rates of pay for extremely scarce expertise and lower rates of pay for people doing more basic jobs.²⁵

14. The Cabinet Office described to us how it believes the civil service needs to change in order to tackle the cultural issues and barriers that have led to the capability gap compared to the private sector. The Cabinet Office told us that it did not think government needed to pay staff a lot more, but also said that the civil service should not be frightened of performance payments as part of remuneration packages. It also said that the civil service does not do enough to reward good people in terms of career progression to more senior and influential commercial roles, or to remove people who are not performing.²⁶ Neither Accounting Officer from the Home Office or the Ministry of Justice was able to convince us that they had significant direct contract management experience themselves, but they reported encouraging signs that permanent secretaries in future would increasingly have operational and commercial experience.²⁷

15. Recommendation: *We welcome progress to improve the government's commercial and contract management skills, but this needs to be supported by concerted Cabinet Office action in two areas: to increase the attractiveness of careers in commercial disciplines including pay, status and career development; and do more to raise the commercial awareness of operational managers so they can work with the commercial professionals to achieve value for money throughout the life of contracts.*

The response in the Ministry of Justice and the Home Office

16. In response to the overbilling crisis on electronic monitoring, the Cabinet Office undertook a review of contract management and required all departments to prepare contract management improvement plans.²⁸ In its comparison of the responses by two departments, the NAO reported that the Ministry of Justice had started from a weaker position than the Home Office, but had responded promptly, with a more comprehensive improvement plan.²⁹ The Ministry of Justice told us its plan is focusing on strengthening senior leadership, and providing commercial training for its senior civil service staff. The Ministry has also put specific arrangements in place for more senior oversight and challenge of operational contracts and both the executive team and departmental board are

23 [C&AG's report, Transforming government's contract management, Paragraphs 12, 2.21](#)

24 [BQ 57](#)

25 [AQ 168](#)

26 [BQ 57](#)

27 [AQq 111-115, 216](#)

28 [BQ 101](#)

29 [C&AG's report, Home Office and Ministry of Justice, Transforming contract management, Paragraph 40](#)

more focused on the issue. The Ministry assured us that it would scale back its outsourcing activity if it did not have the commercial capability to manage it effectively.³⁰

17. The Home Office described how its plan is focusing on training for commercial staff. It has also established a Portfolio and Investment Committee to extend senior scrutiny beyond just new procurements to cover operational contracts. The Home Office told us that it has drawn from the NAO's comparative analysis to adopt some of the Ministry's practices, such as a scorecard for each major contract.³¹ It acknowledged that part of its problems lie outside its commercial directorate, in operational performance management of suppliers. It said that both commercial and performance management needed to improve, though so far it has focused on the former.³²

18. Recommendation: *Alongside the Cabinet Office reporting back to us at the end of 2015, both the Ministry of Justice and the Home Office should report back to us specifically on progress with their contract management improvement plans:*

- *For the Ministry we will be particularly interested in arrangements for running the 'Transforming Rehabilitation' contracts (for outsourcing probation services) which we see as a litmus test for better management of high risk and complex contracts.*
- *For the Home Office we will be particularly interested in what it has done to extend improvement plans beyond its commercial directorate and into the operational management of contracts.*

30 [AQq 143-144, 162, 214-5](#)

31 [AQq 144, 156, 218](#)

32 [AQ 158; C&AG's report, Home Office and Ministry of Justice, Transforming contract management, Paragraph 11](#)

2 Contractor's duty of care to the taxpayer

19. Conclusion: Contractors have not shown an appropriate duty of care to the taxpayer and users of public services.

20. Private sector suppliers need to make a profit. But some suppliers have lost sight of the fact that they are delivering public services. In this section we cover the need to make sure contractors behave in accordance with public service standards, including having performance incentives that are compatible with the public interest and having more effective controls over unethical behaviour.

Incentives and ethical behaviour

21. Research by the Committee of Standards in Public Life shows that the public believes that public services should be delivered to high ethical standards, regardless of whether they are being delivered by government or by a contractor working on government's behalf.³³ Both G4S and Serco accept that they made serious mistakes in their overbilling of government on their electronic monitoring contracts and expressed regret to us. G4S told us "... we made the wrong judgement and we got it wrong, for which we are sorry" and, from Serco, "What happened was totally unacceptable and unethical; frankly, we are deeply ashamed of it".³⁴

22. But electronic tagging is not an isolated case of unethical behaviour and disregard for taxpayers' money. For example, two other G4S contracts have been referred to the Serious Fraud Office to investigate, and another Serco contract has been referred to the City of London police. We have previously reported on Serco's altering of performance data on its contract for out-of-hours GP services in Cornwall.³⁵

23. We questioned whether the incentive cultures within contractors had driven such disregard for taxpayers and service users. G4S told us its staff bonus schemes had been 75% dependent on financial results. Serco did not believe bonuses were a driver of unethical behaviour in its organisation.³⁶ The Comptroller and Auditor General highlighted how large diversified contractors such as G4S and Serco face particular challenges controlling behaviours and performance across their many operations and subsidiaries.³⁷ The Ministry of Justice told us it now looks specifically at contractors' bonus schemes, because it does not want contractor staff incentivised in a way that encourages them to game the contract and damage value for money to the government.³⁸

24. It is not in the long-term interests of any private sector provider to behave unethically. Serco described the fallout from overcharging for electronic tagging as "a disaster" and the

33 [Committee of Standards in Public Life, Ethical standards for providers of public services, paragraph 6](#)

34 [AQq 22, 52](#)

35 [AQ 15, BQq 53-54; C&AG's report, Transforming government's contract management, Paragraph 7; Committee of Public Accounts, The provision of the out-of-hours GP service in Cornwall, HC472, session 2013-14, July 2013](#)

36 [AQq 41, 51](#)

37 [AQq 38, 60, BQ 18](#)

38 [AQ 200](#)

CBI made the point that “*Good behaviour goes hand in hand with operating in this marketplace ... and if you do not do that over a sustained period of time, that is not good business sense.*”³⁹ Contractors are recognising the need for cultural change and we were pleased to hear Serco’s Group Chief Executive tell us that “*there should be a new dispensation, a new way of thinking about how companies do business with the Government, which is that companies owe a duty of care to the taxpayer.*”⁴⁰

25. The NAO has recommended that government should get “written representation from contractors on the integrity of the services they supply, covering the control environment for maintaining ethical behaviour and public service standards. Such statements, while not necessarily carrying additional legal implications, would have symbolic and reputational importance, and give Parliament clear accountability.”⁴¹ We put this to the CBI who told us that this was perfectly feasible as every company has a process around governance, controls and behaviours, while also emphasising that such a requirement would need to be clearly laid out in contracts.⁴² The Committee on Standards in Public Life made a similar recommendation in its June 2014 report, when they called for Accounting Officers to actively seek assurance that public money is being spent in accordance with the high ethical standards expected of all providers of public services. The Chair told us that his Committee was particularly keen on this as a potential means to push for a culture in providers which recognises and rewards high ethical standards.⁴³

26. Recommendation: *The Cabinet Office should work with industry to define what obligations a duty of care should entail, what sanctions would apply should performance fall short, and require senior executives to attest annually to the strength of their internal controls over public contracts and to be personally accountable to Parliament for performance.*

‘Corporate renewal’

27. Following the discovery of overcharging on electronic monitoring, the government asked G4S and Serco to undertake a process of ‘corporate renewal’.⁴⁴ The two firms told us this has involved senior management changes, strengthening of internal controls, ethical training and changes to incentive and reward structures. While we accept that there are new senior managers in place at the firms, the contractors were less clear how corporate renewal has changed day-to-day operations.⁴⁵ The Cabinet Office described how government was engaged in overseeing corporate renewal at a very senior level.⁴⁶ While

39 [AQq 26-27](#), BQ 23

40 [AQq 67-70](#)

41 [C&AG’s Report, Transforming government’s contract management, para 3.17](#)

42 [BQ 12](#)

43 [BQ 11; Committee on Standards in Public Life, Ethical standards for providers of public services, June 2014, page 9](#)

44 [C&AG’s report, Transforming government’s contract management, Paragraph 6](#)

45 [AQ 22, 24 54 61](#)

46 [BQ 47](#)

corporate renewal is ongoing, the firms have continued to deliver government services and win contracts for additional works.⁴⁷

28. Recommendation: *The ‘corporate renewal’ process is a new concept for many. The Cabinet Office and HM Treasury should publish a review of this process and its outcome, and, when disseminating findings, make clear to all departments what it expects them to do differently and what different behaviours departments should expect from the contractors.*

47 Written submissions from [Serco](#), [G4S](#) and [Cabinet Office](#)

3 Management of public service markets

29. Conclusion: *Public service markets are becoming more difficult for government to manage.*

30. An essential part of contracting-out public services is maintaining effective competition for government business, stimulating a constant pressure to innovate and improve. Against a background of increasingly large and dominant suppliers in some markets, in this section we consider: the need to guard against suppliers becoming too dominant to be allowed to fail; the risk of them losing control over all parts of their business, the need for meaningful consequences when they perform poorly; and the need to ensure SMEs can compete for government work.

The consolidation of markets – too important to fail

31. As certain markets for supplying government services have evolved, the risk has emerged that they become dominated by a few large firms, who become so important to the continued provision of services that they cannot be allowed to fail. The NAO reported that, in reacting to G4s's and Serco's overbilling, "government was constrained in its actions and acted as if the firms were too important to fail: their failure could create widespread disruption to public services and government wanted their ongoing participation in competitions."⁴⁸ The Ministry of Justice told us it did not consider the firms to have been too big to fail, while also stating that one of the lessons it has learned is to structure big projects in such a way that no one supplier can have too large a market share.⁴⁹ The Cabinet Office refuted that it had ever thought the firms were too big to fail and, when challenged as to whether government could have brought in other suppliers said "*Certainly in some areas.*"⁵⁰

32. The consolidation of markets into a limited number of viable suppliers can also be a threat to competition, and to the pressure to innovate and improve; which should be part of the benefits of contracting out public services. The Cabinet Office highlighted the risks consolidating markets pose to choice and competitiveness and described one example of a company that had made 77 acquisitions costing £50 billion over a period of six years.⁵¹ The CBI also stressed that effective competition, avoiding over-reliance on a small number of suppliers, is fundamental to ensuring good performance and corporate behaviour.⁵²

33. Government only started relatively recently to understand the extent to which markets for government services have consolidated. The Cabinet Office highlighted that as recently as four years ago government had no cross-government picture of who its major suppliers were and how much business was done with them across government.⁵³ The NAO

48 [C&AG's Report, Transforming government's contract management, para 6](#)

49 [AQ 220](#)

50 [BQq 49-51](#)

51 [BQq 122-124](#)

52 [BQ 29](#)

53 [BQ 89](#)

reported that the Cabinet Office's spending database is steadily improving this information and the Cabinet Office described how it is improving its capability to analyse such data effectively, but there is much further work to be done.⁵⁴

34. Market consolidation not only present risks to competition but also to the companies' ability to manage public services. The Comptroller and Auditor General highlighted the dangers such disorderly growth can present to the ability of contractors to maintain control across fast-growing and diverse businesses. The CBI agreed that the right levels of governance and control were vital in such circumstances, and that contractors convincing themselves that they would deliver things they could not do lay behind much of the recent outcry around outsourced services.⁵⁵

35. The Cabinet Office explained how government contracts contain change of ownership clauses which allow government to intervene when service providers are taken over. The Cabinet Office told us that typically government had not used those clauses to its advantage but, where it had done so it had extracted significant benefit from contractors for the taxpayer.⁵⁶

36. Recommendation: *Led by the Cabinet Office, departments must take concerted action to develop competitive markets for public services. Government must use its contractual powers to intervene in market consolidation so that taxpayers and public service users benefit from the innovation and competition a thriving market can offer.*

Consequences for failure

37. We heard how there was no ban on G4S and Serco winning new work after discovery of the overcharging in July 2013 and during the subsequent 'corporate renewal' period.⁵⁷ The fact that Government gave the impression that all discussion with Serco and G4S were halted whilst investigations took place, whilst in fact the companies have been awarded new contracts in other departments had existing contracts extended and were in negotiation with departments over new contracts is evidence of the over reliance on these larger suppliers.

38. The Cabinet Office told us that, while the man in the street might consider a ban to be appropriate, government had to balance that with EU law. It added that it had oversight of the control environment in government within which it was important to stop contract extensions and that it had 'paused' a number of contract requests. It had also advised the two firms that "*it is probably not welcome for them to bid for new business until they get through this phase.*"⁵⁸ The Home Office described how, in the case of one new contract for which one of the firms would be bidding, it had made it clear that such a bid would not be welcome, and that firm had voluntarily stepped aside.⁵⁹ Serco told us that they considered

54 [BQq 89-90; C&AG's Report, Transforming government's contract management, paragraph 3.6](#)

55 [BQ 18](#)

56 [BQq 138-140](#)

57 [AQq 30-33](#)

58 [BQ 46](#)

59 [AQ 221](#)

themselves “*unawardable*” for any new work during the period through to January 2014 and both firms reported that they had suffered negative financial effects since the discovery of overbilling.⁶⁰

39. Nonetheless, G4S and Serco continued to be awarded work, including both contract extensions and new work, whilst they were under investigation (between July 2013 and January 2014 for Serco and July 2013 and April 2014 for G4S). Written evidence submitted to us after the evidence sessions, from the two firms and from the Cabinet Office, confirmed that while the corporate renewal plans were being agreed, the Ministry of Justice, the Ministry of Defence, the Department of Health, Department for Business, Innovation and Skills and HM Revenue & Customs all awarded additional work to the firms. In its written evidence the Cabinet Office set out a chronology of relevant government statements and contract awards to G4S and Serco during the corporate renewal period, and stated “*We believe that there was a robust cross-government response to the over-billing issues that emerged at MoJ, and that Government worked within legal and operational necessity constraints to limit work placed with both companies.*”⁶¹

40. We also heard the Cabinet Office describe how, in the past, it had been a matter of policy to treat each government department as a separate client, which could not therefore share information on the past performance of a contractor bidding for work with another department. The Cabinet Office told us this has changed and that they do now take account of poor performance in other departments.⁶² The CBI agreed that contractors should be penalised for underperformance, and that it could be appropriate that they should be excluded from competitions where wrongdoing is absolutely proven or past performance in a specific area casts doubt over their ability to deliver. However, both government and the CBI were against the idea of blanket bans from public service markets where contractors have performed poorly or behaved unethically. Government felt this had to be balanced with EU law, while the CBI felt it could be unhelpful by reducing choice.⁶³ The Cabinet Office was clear that it would be obliged to stop doing business with companies which had been convicted of certain crimes, but said it could do other things if they were not actually convicted, such as not giving contract extensions.⁶⁴

41. Recommendation: *All government contracts should include robust sanctions for underperformance or weak control which should be applied rigorously when performance falls short, and performance on previous contracts must always be taken into account when awarding new work.*

Opening up public services to SMEs

42. The CBI outlined some of the familiar difficulties that smaller businesses find when trying to compete in public service markets. These included poor pre-market engagement

60 [AQq 4-5, 14](#)

61 Written submissions from [Serco](#), [G4S](#) and [Cabinet Office](#)

62 [BQ 95](#)

63 [BQ 13-14](#), [BQ 38](#)

64 [BQ 44-45](#)

for them to understand properly what government requires, costly and bureaucratic processes, and the degree of risk being transferred.⁶⁵

43. The Cabinet Office has controls in place that prevent departments letting contracts over £100 million without central approval. It told us that the amount of business that government does with SMEs has risen by about £1.5 billion, or 20%, since 2010, that it has more than halved the average procurement duration (still close to 100 days), and reformed other processes, for example introducing the ‘G-cloud’ through which 90% of companies doing business with government are SMEs. But the Cabinet Office acknowledged that there was more to do on encouraging SMEs to enter markets for government business.⁶⁶

44. Recommendation: *The Cabinet Office should look at the barriers to SMEs joining markets and develop a plan to address each barrier. Departments should be required to demonstrate that they have considered disaggregated models for each major contract.*

65 [BQ 29](#)

66 [BQq 125, 131-133](#), [Written submission from Cabinet Office](#)

4 Rebalancing power in favour of the taxpayer

45. Conclusion: *Government's current approach to contracting gives too much advantage to contractors.*

46. We acknowledge that it is not easy task to keep pace with the commercial and negotiating expertise of the private sector, and deal with large companies that dominate certain markets. In this section we make the point that there is still a great deal of scope for government to rebalance power in favour of the taxpayer. It can do more, for example, to improve the way it monitors performance, exploit open book access to companies, avoid excess profits at the taxpayer's expense, and ensure that spending the taxpayer's pound brings with it an expectation of greater transparency.

Monitoring performance

47. Government's ability to manage 'live' contracts is hindered by ineffective monitoring. The Ministry of Justice described how its electronic monitoring contract had key performance indicators but nothing that alerted managers to the overbilling problem, and how other contracts had far too many performance indicators.⁶⁷ The Cabinet Office also told us that government contracts have typically had too many KPIs, with staff measuring and managing hundreds of performance indicators but still missing what was important around performance.⁶⁸ The Cabinet Office cited good practice in the private sector of exception reports when KPI performance falls below a defined tolerance range, and said that Permanent Secretaries should get regular reports to see whether contracts are within or outside tolerance.⁶⁹ The NAO highlighted progress by the Ministry of Justice on improving the way it measures performance and validates payments, including the expansion of its internal audit coverage of contract management, introduction of 'data scorecards', and the likelihood that on some contracts it can reduce the amount of data it collects.⁷⁰

48. Recommendation: *The Cabinet Office standard operating procedures should require departments to set and regularly review KPI regimes, to ensure they are incentivising the right behaviours, with clearly specified indicators that are capable of highlighting poor performance at an early stage.*

Using open book to align incentives

49. There is now a broad consensus that open-book clauses should be used more in contracts. Contractors need to make a profit, but government needs to know that these profits are made in ways that align with the taxpayers' interests. Profits should vary with

67 [AQ 191, AQ 196](#)

68 [BQ 85](#)

69 [BQ 121](#)

70 [C&AG's Report Ministry of Justice and the Home Office, Transforming Contract Management, paragraphs 36-37.](#)

the level of risk taken on, the level of innovation the contractor provides and, crucially, performance. The Cabinet Office has developed a new model contract which includes open-book clauses and audit rights.⁷¹ For open book access to be effective, departments must understand contractors' business models and therefore be able, for example, to understand cost and profit calculations and identify efficiencies.

50. The Cabinet Office told us that government has open book arrangements on 34% of its contracts, 39% of its larger contracts.⁷² However, open book access alone was not sufficient for the Ministry of Justice to identify the overbilling problem on electronic monitoring.⁷³ Both the Ministry and the Home Office have relied on unaudited contractor data and neither fully used their 'open-book' access rights to understand contractor costs and performance.⁷⁴ The Cabinet Office considered open book practice to be poor on many government contracts. It told us that government lacks the skills required to operate open book effectively and has struggled to recruit such skills.⁷⁵

51. The NAO has stressed that government needs to recognise that value is achieved over the life of a contract, and that officials appear too often to have seen contract management as enforcing the deal that was made when the contract was signed. This approach may work for the simplest of contracts but, for more complex and longer-term contracts, the government needs flexibility to ensure that services continue to meet changing business requirements. If contract management is done well, a department has considerable influence over the contractor even after the initial competition is concluded.⁷⁶ The Cabinet Office described how government can get locked into contracts whose prices rise with inflation while the underlying costs for the contractor have fallen dramatically. It also described how contractors must be incentivised to achieve a reasonable level of profit, based on delivering a good service, and that exercising open book properly would help government to ensure it shared in any excess profits.⁷⁷ Contractors told us they are supportive of the use of open book approaches but it would require consistent treatment and responsibility in the amount of material requested.⁷⁸ The Cabinet Office agreed with the need to act responsibly and not demand unnecessary data.⁷⁹

52. Open book access has to be backed up by the means to act on what it might find - for example, the means to claw-back excess profits or overcharging.⁸⁰ For example, under the Work Programme the Department for Work & Pensions has identified that, up to March 2014, it paid contractors an estimated £11 million in 'sustainment payments' in return for job outcomes which could not be validated. However, its estimate is based on an extrapolation from the sample that it checked, in which it could not verify 7% of payments.

71 [C&AG's Report, *Transforming government's contract management*, para 3.22-3.23.](#)

72 [BQ 98](#)

73 [AQ 191](#)

74 [C&AG's Report *Home Office and the Ministry of Justice, Transforming contract management*, paragraph 34.](#)

75 [BQ 98, BQ 100, 139](#)

76 [C&AG's Report, *Transforming government's contract management*, paras 2.9-2.11](#)

77 [BQ 85, 139](#)

78 [AQ 66, AQ 81](#)

79 [BQ 98](#)

80 [C&AG's Report, *Transforming government's contract management*, paras 3.24-3.25](#)

The Department did not include a clause in Work Programme contracts to claw back invalid sustainment payments based on extrapolation, and so it is dependent on successful renegotiation with contractors to recover any taxpayers' money. This contrasts with the situation on 'job outcome payments' under the Work Programme, where the Department is dealing with the same contractors. For job outcome payments the Department also found that 7% of payments in its sample were invalid, but was entitled to extrapolate across the wider population of payments, and so has recovered £21 million.⁸¹

53. Recommendations: *The Cabinet Office should mandate the inclusion of open book provisions in all government service contracts and set clear expectations for how these provisions should be utilised to manage the contract throughout its life.*

54. Open book provisions need to be supported by means of aligning incentives, such as sanctions if contractors provide incorrect information; the means to recoup any overpayments identified; and mechanisms for profit sharing and ensuring the taxpayer shares in efficiency gains in long term contracts.

55. Departments should avoid unnecessarily fixing prices in long term contracts, particularly in areas of rapidly changing technology, without any flexibility to adapt or the means to share in excess profits.

Transparency to the public

56. Transparency is fundamental to accountability, and supports scrutiny of both government and its contractors. We have stressed before the public's right to more visibility of the taxpayers' pound, wherever it is spent. A citizen, whether from the perspective of funding or receiving contracted out public services, should have easy access to meaningful performance information, and be able to draw matters to government's attention where local knowledge and experience casts doubt on what is being reported. The Cabinet Office remarked that parliamentary and press scrutiny has helped focus government attention on poor practice and the need for improvement.⁸² Referring to companies delivering services on behalf of government, the CBI stated "*It brings with it a greater degree of scrutiny, transparency and behaviour that is commensurate with operating in and delivering public services. That should, rightly, be a given.*"⁸³

57. Both G4S and Serco said they were willing to be more transparent to the public about performance. G4S told us it was working with the CBI on new transparency arrangements, relating to both freedom of information requests and to openness with government departments. Serco described how publication of performance information would itself help drive much better measurement of performance, while also cautioning on the potential barrier to entry that freedom of information obligations could be for SMEs.⁸⁴ On extending freedom of information to the taxpayer funded parts of businesses, the CBI was clear that more transparency was required, and that every contract should stipulate the

81 [C&AG's Report, The Work Programme, HC 266, Session 2014-15, 2 July 2014, paras 4.10-4.16; Written submission from NAO](#)

82 [BQ 78](#)

83 [BQ 6](#)

84 [AQ 25, 66-71](#)

right level of transparency. It also said that both government and contractors have hidden too much behind claims of commercial confidentiality when revealing information publicly.⁸⁵ The NAO report highlighted the Cabinet Office's intention to improve the contract details published on its Contract Finder website.⁸⁶

58. We have also said before how there is too much reliance on whistleblowers bringing problems to light. In our March 2014 report we recommended that departments include a standard term in contracts requiring suppliers to have whistleblowing policies in place, and include a requirement for contractors to nominate designated officials within departments to receive disclosures from whistleblowers.⁸⁷ The Government disagreed with our recommendation, arguing that the existing legal framework provides substantial protection for whistleblowers and stating that it “*expects all suppliers to fully implement the spirit of this legislation*”. It did not believe additional contractual terms were required.⁸⁸ In our view, it is clear that current arrangements have not proved to be adequate and the Chair of the Committee on standards in Public Life also made this point to us.⁸⁹ But in any case we are surprised that there is any reluctance in the current climate to implement a fairly straightforward safeguard against contractors not acting fully in the spirit of legislation. We therefore repeat our recommendation in this report and hope to receive a more constructive response.

59. Recommendations: *The Cabinet Office should require all service contracts to be published, including a clear expression of the performance the service user can expect and then how contractors are performing.*

60. Departments should include a standard term in contracts requiring suppliers to have whistleblowing policies in place. This should require contractors to nominate designated officials within departments to receive disclosures from whistleblowers.

85 [BQ 34, 35](#)

86 [C&AG's report, *Transforming government's contract management*, paragraph 3.6](#)

87 [Committee of Public Accounts, *Contracting out public services to the private sector*, HC 777, Session 2013-14, 14 March 2014](#)

88 [HM Treasury, *Treasury Minutes, Government responses on the Forty Fifth to the Fifty First and the Fifty Third to the Fifty Fifth reports from the Committee of Public Accounts: Session 2013-14*, Cm 8871, 19 June 2014 \(page 17\)](#)

89 [BQ 11](#)

Conclusions and Recommendations

Achieving value for money from contracts

1. Conclusion: The government will not achieve value for money from its contracts until it pays much more attention to contract management
2. Recommendation: The Cabinet Office must lead efforts to make sure that the current emphasis on improving contract management is embedded across all departments and that tendering processes did not discriminate against small and medium sized enterprises. It must not lose focus and should report back to this Committee by the end of 2015 on the progress made in implementing reforms across government
3. Recommendation: Accounting Officers remain accountable for spending throughout the life of contracts. They should put in place an accountability framework for contracts which specifies how senior oversight of major contracts should work in practice - including the information needed to scrutinise and challenge contractor performance, cost and progress in making further savings—and the personal responsibilities of senior managers, with appropriate sanctions and rewards for performance.
4. Recommendation: We welcome progress to improve the government's commercial and contract management skills, but this needs to be supported by concerted Cabinet Office action in two areas: to increase the attractiveness of careers in commercial disciplines including pay, status and career development; and do more to raise the commercial awareness of operational managers so they can work with the commercial professionals to achieve value for money throughout the life of contracts.
5. Recommendation: Alongside the Cabinet Office reporting back to us at the end of 2015, both the Ministry of Justice and the Home Office should report back to us specifically on progress with their contract management improvement plans:
 - For the Ministry we will be particularly interested in arrangements for running the 'Transforming Rehabilitation' contracts (for outsourcing probation services) which we see as a litmus test for better management of high risk and complex contracts.
 - For the Home Office we will be particularly interested in what it has done to extend improvement plans beyond its commercial directorate and into the operational management of contracts.

Contractor's duty of care to the taxpayer

6. Conclusion: Contractors have not shown an appropriate duty of care to the taxpayer and users of public services.

7. Recommendation: The Cabinet Office should work with industry to define what obligations a duty of care should entail, what sanctions would apply should performance fall short, and require senior executives to attest annually to the strength of their internal controls over public contracts and to be personally accountable to parliament for performance.
8. Recommendation: The 'corporate renewal' process is a new concept for many. The Cabinet Office and HM Treasury should publish a review of this process and its outcome, and, when disseminating findings, make clear to all departments what it expects them to do differently and what different behaviours departments should expect from the contractors.

Management of public service markets

9. Conclusion: Public service markets are becoming more difficult for government to manage.
10. Recommendation: Led by the Cabinet Office, departments must take concerted action to develop competitive markets for public services. Government must use its contractual powers to intervene in market consolidation - so that taxpayers and public service users benefit from the innovation and competition a thriving market can offer.
11. Recommendation: All government contracts should include robust sanctions for underperformance or weak control which should be applied rigorously when performance falls short, and performance on previous contracts must always be taken into account when awarding new work.
12. Recommendation: The Cabinet Office should look at the barriers to SMEs joining markets and develop a plan to address each barrier. Departments should be required to demonstrate that they have considered disaggregated models for each major contract

Rebalancing power in favour of the taxpayer

13. Conclusion: Government's current approach to contracting gives too much advantage to contractors.
14. Recommendation: The Cabinet Office standard operating procedures should require departments to set and regularly review KPI regimes, to ensure they are incentivising the right behaviours, with clearly specified indicators that are capable of highlighting poor performance at an early stage.
15. Recommendation: The Cabinet Office should mandate the inclusion of open book provisions in all government service contracts and set clear expectations for how these provisions should be utilised to manage the contract throughout its life.

16. Recommendation: The Cabinet Office should require all service contracts to be published, including a clear expression of the performance the service user can expect and then how contractors are performing.

Formal Minutes

Wednesday 26 November 2014

Members present:

Mrs Margaret Hodge, in the Chair

Mr Richard Bacon	Austin Mitchell
Chris Heaton-Harris	Stephen Phillips
Meg Hillier	John Pugh
Anne McGuire	

Draft Report (Transforming contract management), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 60 read and agreed to.

Conclusions and recommendations agreed to.

Summary agreed to.

Resolved, That the Report be the Twenty-third Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned till Monday 1 December at 3.00 pm]

Witnesses

Monday 8 September 2014¹

Page

Rupert Soames, Group Chief Executive, Serco; **James Thorburn**, Managing Director for Home Affairs, Serco; **Peter Neden**, Regional President UK and Ireland, G4S; and **Jean Pierre Taillon**, Managing Director, UK Government Services, G4S

[Q1, HC 585](#)

Dame Ursula Brennan, Permanent Secretary, Ministry of Justice; **Ann Beasley**, Director General of Finance, Ministry of Justice; **Mark Sedwill**, Permanent Secretary, Home Office; and **Mike Parsons**, Chief Operating Officer, Home Office,

[Q111, HC 585](#)

Wednesday 10 September 2014²

Lord Bew, Chair, Committee on Standards in Public Life; **Matthew Fells**, Director for Competitive Markets, CBI; **Ruby McGregor-Smith**, Chair, Public Strategy Board, CBI, and CEO, Mitie

[Q1, HC 586](#)

Bill Crothers, Chief Procurement Officer, Cabinet Office; **Vincent Godfrey**, Director of Procurement, Ministry of Justice and Crown Representative for Serco; **Stephen Kelly**, Chief Operating Officer, Cabinet Office; and **Ian Tyler**, Crown Representative for G4S

[Q37, HC 586](#)

List of printed written evidence

The following written evidence was received and can be viewed on the Committee's inquiry web page at <http://www.parliament.uk/business/committees/committees-a-z/commons-select/public-accounts-committee/inquiries/parliament-2010/transforming-governments-contract-management/>

CON numbers are generated by the evidence processing system and so may not be complete.

- 1 Cabinet Office ([CON0008](#))
- 2 Cabinet Office ([CON0010](#))
- 3 G4S ([CON0002](#))
- 4 Home Office ([CON0006](#))
- 5 Ministry Of Justice ([CON0003](#))
- 6 Ministry Of Justice ([CON0004](#))
- 7 National Audit Office ([CON0009](#))
- 8 National Audit Office ([CON0011](#))
- 9 Serco ([CON0001](#))
- 10 Serco ([CON0005](#))

¹ Reference in the report as AQ

² Reference in the report as BQ

List of Reports from the Committee during the current session

The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

Session 2014–15

First Report	Personal Independence Payment	HC 280
Second Report	Help to Buy equity loans	HC 281
Third Report	Tax reliefs	HC 282
Fourth Report	Monitor: regulating NHS Foundation Trusts	HC 407
Fifth Report	Infrastructure investment: impact on consumer bills	HC 406
Sixth Report	Adult social care in England	HC 518
Seventh Report	Managing debt owed to central government	HC 555
Eighth Report	Crossrail	HC 574
Ninth Report	Whistleblowing	HC 593
Tenth Report	Major Projects Authority	HC 147
Eleventh Report	Army 2020	HC 104
Twelfth Report	Update on preparations for smart metering	HC 103
Thirteenth Report	Local government funding: assurance to Parliament	HC 456
Fourteenth Report	DEFRA: oversight of three PFI waste projects	HC 106
Fifteenth Report	Maintaining strategic infrastructure: roads	HC 105
Sixteenth Report	Early contracts for renewable electricity	HC 454
Seventeenth Report	Child maintenance 2012 scheme: early progress	HC 455
Nineteenth Report	The centre of government	HC 107
Twentieth Report	Reforming the UK Border and Immigration System	HC 584
Twenty First Report	The Work Programme	HC 457
Twenty Second Report	Out-of-hours GP services in England	HC 583