Contract Management

Better Practice Guide

February 2001
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The Australian National Audit Office (ANAO) produces better practice guides as part of its integrated audit approach which includes providing information support services to audit clients.

A Better Practice Series has been established to deal with key aspects of the control structures of entities—an integral part of good corporate governance.

This Guide forms part of that series. It deals with contract management within a risk framework, specifically dealing with day-to-day contract management matters. The primary focus is on achieving required results and value for money.

These Guides or summaries are available from the ANAO web site—http://www.anao.gov.au

Acknowledgments

This Guide has been prepared with valuable assistance and insights from a number of Commonwealth organisations, primarily:

- Australian National University;
- Department of Communication, Information Technology and the Arts;
- Department of Veterans’ Affairs;
- Royal Australian Mint; and
- National Capital Authority.

The ANAO also records its appreciation for the valuable assistance and for the use of material developed by Currie & Brown and BRWMTS Group Pty Ltd.
Auditor-General’s foreword

A large amount of information and better practice guidance has been issued on the topic of contracting, predominantly focused on the front-end of the contract process, that is, those stages leading to signing the contract. Audits undertaken in recent years generally indicate these stages are carried out quite well.

Our audits have also suggested that public sector managers are proficient at specifying their needs in tender documents and undertaking a tender evaluation process. However, organisations are less successful in seeking innovative solutions to the achievement of business outcomes from tenderers through the tender process for the achievement of required results. There also exists considerable room for improvement in the management of contracts. One of the most frequently asked questions during audits on contract management is where information and guidance can be found on better practice once the contract is signed.

The real work associated with contracts, particularly those close to an organisation’s core business and critical to its desired outcome(s), starts after the successful tenderer is identified and the contract is signed. However, as is being constantly reinforced, clear identification and articulation of contract requirements at the outset can save considerable time, cost and effort later in contract management. While this Guide is concerned with contracts rather than agreements or memorandum of understanding, such as those between public sector departments and agencies, there are many elements that are similar. One factor which experience shows can benefit all parties is to ensure at least some continuity between those involved in the tender stage and the contract negotiation stage and the actual contract management.

Private sector service providers are in business to primarily make a profit and to increase shareholder value. Commonwealth organisations, the recipients of these services, enter into the contracts primarily seeking the best value for money. These views are not mutually exclusive. Both can create significant risks and opportunities. Some of these risks can be managed through establishment of an effective operational framework during the contract negotiations, which goes a long way to enabling effective management of the contract over its life.

If parties enter into a contract with a good understanding of the other’s objectives, needs, goals and risks, it is possible that a best-fit solution will be found for the service delivery and opportunities for improved outcomes can be maximised for all concerned. This is what contract management should be about.
This Better Practice Guide contains research and experiences of better practices in contract management in Australia and internationally. It places considerable emphasis on achieving an appropriate contract relationship to best manage risk in each situation. While we expect contract managers to deal with these issues, it is the responsibility of chief executives and senior management to ensure their people are adequately skilled, empowered and resourced to enable them to do their job efficiently and effectively.

It is important that users take the ideas in this Better Practice Guide and adapt them appropriately to suit the needs of their particular organisation and the risks, nature and complexity of individual contracts. One size does not fit all circumstances. This Guide does not promote change for the sake of change. Rather, it provides a basis on which administrative processes may be considered against a well-designed risk management framework that encourages a focus on outcomes and results.

P.J. Barrett
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The focus of this Guide

The focus of this Guide is the process for ensuring reliable delivery of goods or services by external suppliers and encompasses:

- ongoing, or day-to-day, management of the contract; and
- evaluation of the overall performance of the contract to enable effective succession planning at the conclusion of the contract.

This Guide focuses on the application of risk management, which is an integral part of the contract management process, particularly the transition phase, ongoing management and succession planning associated with contracted goods or services.

This Guide does not provide advice for all types of contracts and contract situations. In the complex and ever-changing world of contracts, it is not practicable for one Guide to cover all the issues facing contract managers of very large and complex contracts, such as those for major construction or defence work. This Guide focuses specifically on the management of contracts as opposed to the management of projects.

The ANAO has endeavoured to provide general advice to contract managers in this Guide for the operational or administrative areas of organisations that are managing one or more small to medium contracts on a day-to-day basis. Methods for assisting in the management of contracts have been included that may not be necessary or appropriate for all contracts. Contract managers should, however, be aware of these practices in order to identify opportunities for improvement.

Effective contract management is also supported by a legislative and procedural framework that includes the Financial Management and Accountability Act 1997, the Commonwealth Authorities and Companies Act 1997, Chief Executive Officer instructions and the Commonwealth Procurement Guidelines.

This Guide provides high-level information and is designed to assist contract managers with limited contract management experience or those looking to improve the systems and processes they have in place. It is not intended to be a detailed guide for day-to-day contract management.
**This Guide in the context of the Contract Management Lifecycle**

In its publication on competitive tendering and contracting\(^1\), the Department of Finance and Administration identifies the following seven steps in the contract management lifecycle:

<table>
<thead>
<tr>
<th>Step</th>
<th>Lifecycle Activity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Step 1</td>
<td>Specifying the activity</td>
</tr>
<tr>
<td>Step 2</td>
<td>Selecting the acquisition strategy</td>
</tr>
<tr>
<td>Step 3</td>
<td>Developing and releasing the tender documentation</td>
</tr>
<tr>
<td>Step 4</td>
<td>Evaluating the tender bids</td>
</tr>
<tr>
<td>Step 5</td>
<td>Decision and implementation</td>
</tr>
<tr>
<td>Step 6</td>
<td>Ongoing management</td>
</tr>
<tr>
<td>Step 7</td>
<td>Evaluation and succession planning</td>
</tr>
</tbody>
</table>

There has been considerable research and guidance written to assist in managing the risks associated with the first four steps in the contract management lifecycle—those leading to signing the contract. Some relevant publications include:

- *Before you sign the dotted line*\(^2\);
- *The Performance Improvement Lifecycle*\(^3\); and
- *Commonwealth Procurement Guidelines*\(^4\).

More recently, the ANAO published the better practice guide *Selecting Suppliers*\(^5\) which expanded on the above publications and provided detailed guidance, consistent with the Commonwealth’s procurement requirements, and checklists to assist in assessing and managing the risks associated with selecting suppliers prior to awarding the contract. In addition, the Joint Committee of Public Accounts and Audit recently published Report 379—*Contract Management in the Australian Public Service*—October 2000 which provides a Parliamentary perspective on contract management.

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\(^1\) Competitive Tendering and Contracting: Guidance for managers, Department of Finance and Administration, March 1998  
\(^2\) Before you sign the dotted line, MAB/MIAC Report 23, May 1997  
\(^3\) The Performance Improvement Lifecycle, Guidance for managers, Department of Finance and Administration, March 1998  
\(^4\) Commonwealth Procurement Guidelines, Guidance for managers, Department of Finance and Administration, March 1998  
\(^5\) Selecting Suppliers: Managing the risk, Australian National Audit Office, October 1998
There has been limited recent research and guidance issued on management of the contract after a provider has been selected. This Guide seeks to help fill that gap by providing information on, and assistance in, managing the risks associated with the last three steps in the contract management lifecycle, namely:

- transition (implementation);
- ongoing management; and
- evaluation and succession planning.

Contract managers should, where appropriate, also seek legal advice to assist in managing the risks.

**This Guide in the context of Contract Relationships**

Effective contract management goes beyond holding providers to account for each minute detail of the contract. To get the most from a contract, the contract manager and provider need to foster a relationship supporting the objectives of both parties and which focuses on results to be achieved.

Contract administration relationships can generally be categorised as either traditional or non-traditional:

- the traditional relationship is formal, with an approach based on control by the purchaser and compliance by the provider; and
- non-traditional relationships are categorised as flexible and cooperative arrangements in which the purchaser and provider share common goals.

The four common relationship types form a continuum as follows:

**Figure 1—The contract relationship continuum**

This Guide focuses on the application of risk management to each of the final contract management lifecycle stages (Part 1) and endeavours to provide both practical advice and examples of better practice to assist contract managers to establish a framework for the transition phase (Part 2.1), ongoing management (Part 2.2) and contract succession (Part 2.3) stages of the contract management lifecycle.
The principles and practices outlined in this Guide have been drawn from a number of Commonwealth organisations. As part of our research the web sites listed in Table 2 were identified as providing useful information.

Table 2—Web sites for further information

<table>
<thead>
<tr>
<th>Address</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>WA State Supply Commission [<a href="http://www.ssc.wa.gov.au">www.ssc.wa.gov.au</a>]</td>
<td>Includes a policy guide containing a number of useful better practices covering all phases of the contract lifecycle</td>
</tr>
<tr>
<td>UK HM Treasury, Central Unit on Procurement [<a href="http://www.hm-treasury.gov.uk">www.hm-treasury.gov.uk</a>]</td>
<td>Contains links to a number of guidance releases covering all aspects of contract management and procurement. Of particular interest is Guide No. 61 which can be found at: [<a href="http://www.hm-treasury.gov.uk/pub/html/docs/cup/cup61.pdf">www.hm-treasury.gov.uk/pub/html/docs/cup/cup61.pdf</a>]</td>
</tr>
<tr>
<td>Department of Finance and Administration [<a href="http://www.ctc.gov.au">www.ctc.gov.au</a>]</td>
<td>Competitive Tendering and Contracting site. Contains information relating to Commonwealth procurement and links to other useful contract management related sites</td>
</tr>
<tr>
<td>Department of Veterans’ Affairs [<a href="http://www.dva.gov.au">www.dva.gov.au</a>]</td>
<td>Sample contracts and ideas on how they can be structured</td>
</tr>
<tr>
<td>Australian National University [<a href="http://www.anu.edu.au/finance/manual/index.htm#500">www.anu.edu.au/finance/manual/index.htm#500</a>]</td>
<td>Comprehensive list of purchasing and contract management policies and guidelines</td>
</tr>
</tbody>
</table>

*Web site addresses as at 29 January 2001*
Part 1
Risk management and contracts

Well-managed contracts can deliver significant benefits to an organisation. The difference between a contract delivering benefits and one that does not can be often attributed to the way that the risks associated with the delivery of those services are managed. Organisations may apply the principles of risk management to core business processes, but often do not effectively apply those same principles to contract management. While the provider may have more control over the risks associated with contract delivery, there is much the contract manager can do to plan for and contend with the impact of those risks.

The risk management process generally used in Australia and the Commonwealth today (and adopted in this Guide) is modelled on the Australian/New Zealand Standard AS/NZS 4360:1999 Risk Management. The publications referred to earlier in this Guide are based on a risk management methodology consistent with the Standard. For further information on managing risks, refer to the ANAO’s Better Practice Guide publication, “Business Continuity Management”8. In addition, the ANAO has recently undertaken a number of audits of risk management in the Australian Public Service, including Risk Management of Individual Taxpayer Refunds9 and Commonwealth Foreign Exchange Risk Management Practices10.

The Standard promotes a systematic methodology for identifying, assessing, treating and monitoring risks. In this context risks are defined as events that will impact on the ability of an organisation to achieve its objectives. Ideally, the risk management process should be applied to each step of the contract management lifecycle.

A comprehensive approach to risk management considers risk treatments both actively (designing and implementing controls to prevent the risk events occurring) and re-actively (to mitigate the consequences should the risk events actually occur). Risk management, through structured decision making and a comprehensive analysis of business processes, provides opportunities for innovation and enhanced outcomes. Importantly, it is an on-going process.

7 Guidelines for Managing Risk in the Australian Public Service, Report No. 22, MAB/MIAC, October 1996
8 Business Continuity Management—Keeping the Wheels in Motion, A Guide to Effective Control, ANAO, January 2000
9 Risk Management of Individual Taxpayer Refunds, Audit Report No. 27, ANAO, January 2000
Figure 2 provides an overview of the risk management process.

**Figure 2—Overview of the risk management process**

<table>
<thead>
<tr>
<th>Step 1 Establish Context</th>
<th>Determine key business objectives, processes and resources</th>
</tr>
</thead>
<tbody>
<tr>
<td>Step 2 Assess Risks</td>
<td>Identify, analyse, rate and prioritise risks associated with the contract. Evaluate design of existing controls and treatments. Redesign controls and treatments if necessary</td>
</tr>
<tr>
<td>Step 3 Implement Treatments</td>
<td>Establish a risk management plan. Implement controls and treatments</td>
</tr>
<tr>
<td>Step 4 Monitor and Review</td>
<td>Review operation of controls and continuing suitability of treatments. Review risk assessments</td>
</tr>
</tbody>
</table>

Each of these steps is discussed below.

**Step one: Establish context**

The first stage in the risk management process, with regard to contract management, is ensuring the contract is understood, by all parties, in the overall context of the organisation (Figure 3), that is:

- the outputs that the contracted services support;
- the critical success factors to the delivery of the outputs; and
- the internal input necessary for the delivery of the outputs.

When developing a strategy for managing the risks associated with contract management, it is important to have a thorough understanding of the services being delivered under the contract, the business outcomes and outputs those services support, the management environment and the business risks associated with that environment.
This information establishes the context that defines the overall priority of the contract to the organisation’s business. In turn, this priority determines the level of resources that should be allocated to the risk management and contract management processes.

By identifying the key business outcomes that are dependent upon contracted arrangements, this first step in overall risk management provides essential input to the risk identification and assessment process (Step 2).

**Figure 3—Establishing the organisational context**

Organisations should identify their key business processes and business support processes and relate them to their overall outcomes and outputs. These activities, including the use of outsourced arrangements and contracts, and resources attributable to these critical processes, should be afforded the highest priority in undertaking risk assessments.

**Step two: Assess risks**

In this step the organisation needs to:

- identify all non-trivial business risks (risk identification);
- analyse those risks (risk analysis); and
- design treatments that reduce the risks to an acceptable level (risk treatment design).
Once risks have been identified, they are analysed in terms of their likelihood and consequences. Each of the above steps is discussed sequentially in the following pages.

**Figure 4—Outline of the risk assessment phase of the risk management process**

- **IDENTIFY**
  - Determine possible risk events using risk framework

- **ANALYSE**
  - Determine likelihood and consequence without control
  - Determine likelihood and consequence with control
  - Evaluate design of existing controls and treatments
  - Determine risk level and compare with acceptable risk

- **ASSESS**
  - Acceptable? (No) → Redesign controls and other treatments
  - Acceptable? (Yes) → Record in risk register

- **TREAT**

- **DOCUMENT**

Figure 4 outlines the risk assessment phase of the risk management process and illustrates an approach that analyses risks before and after consideration of controls.
Risk identification

There are at least two levels of risk associated with contracted service delivery:

- contract risk—the risk associated with the delivery of the service; and
- contract management risk—the risk associated with the management of the contract.

The principal contract risk to be managed is that the services will not be delivered in accordance with the requirements of the contract in terms of time, cost, quality and quantity. Many contract risks may arise externally and generally may be considered ‘beyond our control’. However, contract managers can establish an appropriate management framework that contributes to delivery standards being maintained and contingency arrangements to deal with unexpected problems as they arise.

The contract management risks are generally lower and arise from within the organisation (that is they are less likely to threaten delivery of service on which a key business process relies). Nevertheless, if the contract management is substandard, it may lead to erosion of the contract relationship and ultimately adversely affect service delivery. Figure 5 provides some examples of the more common internal and external risks found in contract management.
Figure 5—External and Internal Risks

**External Risks**

<table>
<thead>
<tr>
<th>POLITICAL/REGULATORY</th>
<th>ENVIRONMENTAL/NATURAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Changes to administrative arrangements</td>
<td>Fire/Flood</td>
</tr>
<tr>
<td>Policy changes</td>
<td>Earthquake</td>
</tr>
<tr>
<td>Changes of government</td>
<td></td>
</tr>
</tbody>
</table>

**Internal Risks**

- **Strategic**
  - Key outputs are not identified
  - Performance targets are not aligned with outputs
  - Contract manager has a skills/knowledge gap
  - Business objectives change

- **Operational**
  - Failure to meet output targets for time, cost, quantity or quality
  - Performance management information system
  - Operational staff lack experience to meet targets for time and quality
  - Environment and safety requirements

- Pricing reviews
- Rise in costs of inputs
- Contractor business failure
- Economic downturn

**ECONOMIC/MARKET**

- Virus, hacking
- Network failure

**TECHNOLOGICAL**

- Fire/Flood
- Earthquake
Once the organisation has identified the contract risks, they need to be analysed. The exposures associated with contracted service delivery will most likely have a detrimental impact on the organisation’s outputs, but that will not always be the sole impact. Analysis of current business processes in assessing contract risks can also provide opportunities to identify better ways of doing things and thereby enhance the operations of the organisation. Alternatively, inadequate delivery through either a failure of the service provider or poor contract management may also impact the organisation’s resources, reputation, compliance and may even cause business interruption. Invariably, there will always be an impact on clients where failure is associated with a key business process.

The business impacts (risk consequences) of contracted service delivery and contract management can arise from a range of risk events. Management should assess each event to determine if its occurrence could adversely affect the business objectives underpinned by the contracted service delivery.

Events with a direct, detrimental effect on the ability of the organisation to manage its contracts (or on the supplier achieving the specified delivery
standards in terms of time, cost, quality and quantity) are likely to have some
business impacts. These impact areas may be categorised by outputs, resources,
reputation, business interruption, compliance and clients/stakeholders.

The analysis of business impact relies on establishing relevant evaluation criteria
to assist in determining how significant a risk event will be. The criteria should
be established on an escalating scale (low to high risk) against which the impact
can be assessed.

**Risk treatment design**

The final step in risk assessment is to design appropriate risk treatments for the
identified risks. The treatment options available to an organisation range from
accepting the risk (where it cannot otherwise be cost-effectively managed),
controlling the risk, through to transferring at least some of the risk.

It is not unusual for an organisation to enter into contractual arrangements in
order to transfer risks, but not accountability. In a small organisation this may be
in recognition of insufficient resources or expertise to deal with anticipated
workloads, or simply to outsource delivery of a process not considered to be
part of the organisation’s ‘core business’. Whatever the reason, contracts may
transfer and mitigate one risk factor, but will create another risk factor in
contract management.

In the context of contract management, the contract manager should consider a
combination of preventative and detective controls to minimise the risk of
failures in contract service delivery. The level and complexity of these controls
will be directly proportional to the assessment of the importance of the
contracted services (and the risk assessment undertaken) in achieving the
business objectives and outputs of the organisation.

Contract managers should consider controls that will minimise the risks
associated with:

- business outputs, eg. specified or planned levels of output activity cannot be
  achieved;
- resources, eg. the organisation suffers financial hardship as a consequence of
  the contract, substandard delivery or poor contract management;
- government accountability requirements and organisational reputation, eg.
  the contract itself, contract delivery or management of the contract leads to
  public embarrassment;
- business interruption, eg. failure in contract delivery causes an interruption to
  one or several key business processes;
- client and stakeholder interests, eg. clients and stakeholders suffer due to
  substandard contract performance or poor contract management (this may
  include the service provider itself); and
- business exposure, eg. the contract, contract delivery, or contract
  management process lead to a legal or administrative exposure (which may,
  in turn, lead to a financial exposure to the organisation).
Step three: implement treatments

This step in the risk management process requires organisations to establish a plan for implementing any new treatments, additional controls, or modifications to existing controls arising from the risk assessment phase.

The implementation plan should address contract risk management policies and procedures if they do not already exist. The strategies, plans and performance measures used in contract management are those treatments chosen to address or control the contract risks.

If the risk assessment process has functioned effectively it will have identified controls and treatments that reduce the overall likelihood and consequences of all risk events to an acceptable level.

Contract management policies and procedures will rely on a combination of preventative and corrective controls to be truly effective.
The Australian/New Zealand Standard AS/NZS 4360:1999 *Risk Management* recommends, as a minimum, documenting:

- who has overall responsibility for the implementation of the plan;
- what resources are to be utilised;
- the budget allocation;
- a timetable for implementation; and
- details of the mechanisms and frequency of reviews of organisational compliance with the treatment plan.

The design of treatments needs to consider what should be done in advance to minimise the consequences of a risk event and what should be done if, despite the organisation’s best efforts in managing the risk, the event still occurs and has a detrimental impact. For example, some organisations establish contracts for the supply of essential goods and services with a panel of suppliers. In the event that one supplier fails to deliver in line with agreed standards, orders can be placed at short notice with other suppliers on the panel.

### Step four: monitor and review

The objective of the final step in the risk management process is to monitor the risks and the effectiveness of the controls over time to ensure changing circumstances do not alter risk priorities or weaken the operation of controls. Like any other controls, those used in contract management need to be reviewed regularly for effectiveness. Changes to the organisation’s objectives, structure or any other circumstances should be examined to ensure the controls in place for contract management remain valid and are the most appropriate to support the outcomes and outputs of the organisation. This, in turn, suggests controls should be flexible and adapt to the changing needs of the organisation.

### The impact of risk on relationships

As the four relationship types exist along the continuum of relationship styles (Figure 1), different features may be ‘mixed and matched’ to develop the most appropriate relationship style for the organisation and the particular contract.

In designing the most appropriate relationship, the risks of providing the service are critical to the decision process. The likelihood and consequence of failure affect risk. The relationship chosen is part of the treatment of the identified risk, that is, a means by which the risk will be controlled. The following figure demonstrates the link between risk and the relationship type. While the figure provides some examples of the type of goods or services that may be provided under the various relationship types, the choice depends on the organisation’s specific needs.
Whatever the choice, the relationship must fit the objectives of the service and the values and experience of both provider and purchaser.

**The application of risk to contract management**

Desirably, the provider would seek to address many of the risks included in Table 3, prior to implementation of the contract, for example ensuring a common understanding of the contract and its requirements before signing. Risks associated with the transition phase, ongoing management, and succession phases of the contract management lifecycle should be considered against the various steps in the framework for risk management. These considerations form the basis of the remainder of this Guide.
<table>
<thead>
<tr>
<th>Risk management step</th>
<th>Transition in</th>
<th>Ongoing management</th>
<th>Contract succession</th>
</tr>
</thead>
<tbody>
<tr>
<td>Establish context</td>
<td></td>
<td>• announce decision to stakeholders and brief unsuccessful tenderers</td>
<td>• undertake review of the contract and service delivery to identify possible areas for improvement</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• prepare for new service delivery arrangements with successful tenderer</td>
<td></td>
</tr>
<tr>
<td>Assess risks</td>
<td></td>
<td>• does the tenderer understand the contract requirements?</td>
<td>• timeliness of review</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• will the implementation be delayed?</td>
<td>• new organisation priorities and objectives not considered</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• what relationship will evolve?</td>
<td>• has the market been adequately tested?</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• have sufficient resources been allocated?</td>
<td>• has the opportunity to improve the relationship or pricing structure been considered?</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• is the fee structure appropriate?</td>
<td></td>
</tr>
<tr>
<td>Implement treatments</td>
<td></td>
<td>• implementation strategy, including purpose of contract</td>
<td>• succession strategy</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• transition in plan</td>
<td>• ongoing reviews of the market</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• establishing workable relationship</td>
<td>• independent performance review panel</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• use appropriate legal advice</td>
<td>• use of industry network groups</td>
</tr>
<tr>
<td>Monitor and review</td>
<td></td>
<td>• ensure success of the transition in phase</td>
<td>• evaluate performance</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• both parties should test the adequacy of performance measures during the life of the contract</td>
<td>• review previous succession exercises and apply 'lessons learned' to achieve better practice</td>
</tr>
</tbody>
</table>
With risk considerations in mind, contract managers have a number of other key areas to address to ensure that optimum results are gained from the contracting of services.

The objectives of contract management are to ensure:

- goods or services are delivered under contract according to the time, cost, quantity and/or quality standards specified in the contract; and
- the organisation has sufficient information to enable it to make a decision regarding succession arrangements at the conclusion of the term of the contract.

Beyond the terms and conditions of the contract, contract management has three key stages:

- transition phase (or implementation);
- ongoing day-to-day management; and
- evaluation and succession planning.

This Part of the Guide discusses the steps to be carried out by contract managers in undertaking the transition phase; facilitating effective ongoing management; and developing a well thought out succession plan. The extent to which these stages require individual strategies will depend upon both the risk assessment and the nature and complexity of the contracts.

The Guide addresses each of these stages on the understanding that much of what dictates the behaviour and expectations of each party are the terms and conditions of the contract and the risks to be managed. Once the contract is agreed to, the terms and conditions form the basis of all activity relating to the provision of the goods or services and are therefore taken as a given in this Guide.
Part 2.1
Transition phase (Implementation)

Introduction

The first phase of contract management, the transition period, commences from the time the supplier is selected and runs through to a time agreed by contracting parties. It normally ends at the commencement date of the contract but can extend for a period following commencement, depending on the nature and complexity of the contract and the time available to complete the required transition phase.

When the details of the contract are finalised, a strategy for smooth transition from the old arrangements to the new arrangements should be developed. The number of associated issues (and effort required to manage them) will depend on the nature, range and complexity of the services being provided.

Objectives

The objectives of the transition phase are to establish a strategy to manage the transition to contracted service delivery, minimising the chances of a loss of service delivery and the impact on clients and other stakeholders.

The steps to be taken during transition include:

• announcing the decision;
• establishing the contract relationship, if not already developed;
• developing a transition strategy;
• preparing the resource plan; and
• undertaking a post transition review.

Underpinning these steps is a proper understanding of the provider’s position and the terms and conditions of the contract.

It is possible that the contract relationship, the transition strategy and the resource plan could be established as part of the tender negotiations.

Each of the above steps is addressed below. The final section of this Part deals with other issues to consider in the transition phase.

Outputs

At the end of this phase, the organisation should have a number of agreed processes documented and implemented. The primary documents will be:

• an agreed transition strategy, including a procedural manual;
• an agreed resource plan; and
• a post transition review report.
**Announcing the decision**

Once the decision to contract has been made and the provider selected, the choice of provider should be announced as soon as practicable. Importantly, when the outcome of the tender process is known, the following parties should be advised:

- the recommended tenderer;
- unsuccessful tenderers;
- staff; and
- other key clients and stakeholders.

Unsuccessful tenderers should be advised quickly. It is Commonwealth policy that unsuccessful tenderers be offered a written or oral debriefing on why their tenders were unsuccessful. Debriefing tenderers in a frank and fair manner is important to the development of long term relationships with prospective providers. Moreover, debriefing assists tenderers to further improve their products or services, thus improving their competitiveness in future tenders. Tenderers should be debriefed one at a time in a sensitive and professional manner using the evaluation criteria from the Request for Tender documentation. Comparisons with other tenders should not be made.

Organisations should consider developing information packages to be issued to the stakeholder groups and briefing material to be used by management to address the information needs of the management and staff. It is important that the information provided to all the stakeholders is complete, clear and consistent.

A critical area to consider in assessing and controlling the risks associated with announcing a contracting decision is communication. The range of communication needs depend on the nature and complexity of the contract and its impact on stakeholders. The communication skills of contract managers required in managing the transition phase encompass:

- **writing**—preparation of targeted information packages for distribution to stakeholders and ability to respond quickly to requests for written information;
- **negotiating**—the ability to be persuasive and deal with tenderers, clients and stakeholders face-to-face during the transition period;
- **presenting**—it may be necessary to give presentations to a variety of groups where knowledge of the subject matter and confidence will be the key to success; and
- **facilitation**—meetings between stakeholders requiring resolution of issues and agreed outcomes will require the use of objective facilitation methods by the contract manager. In situations where conflicts arise, independent facilitators may be required to elicit the issues, develop consensus and debrief participants.
Organisations should review their capacity to communicate effectively during this stage. Where there are identified deficiencies in relevant areas of communication, it would be prudent to consider appointing expert assistance.

**Establishing the contract relationship**

Announcing the decision to the successful tenderer is the first step in establishing the working relationship that will underpin the service delivery. The future quality of the relationship will depend as much on the effort and commitment put in by the organisation up-front, as the on-going effort throughout the contract term.

The factors to consider in developing an appropriate relationship are discussed in Part 2.3 on Contract Succession. There is no given relationship type for a contract. Each relationship will develop according to the context of the contract, the risk assessment undertaken, the size and complexity of the contract, the nature and personalities of management of the purchaser and provider and the commitment to maintaining the relationship.

One of the key elements of a successful relationship is good communication. A contract will generally be successful if the purchaser/provider relationship is positive. Clear and regular communication assists. The following are some of the key communication issues in achieving a successful relationship:

- it is important that, if conflicts or performance issues do arise, adequate time is taken to obtain the facts and find a mutually agreed solution; and
- building rapport with the other party may also help communication, eg. by identifying and exploring common interests and views.

It is not usual for us to place trust in people that we don’t know well. Consequently, the development of trust needs to be taken one step at a time. The following measures will assist contract managers in strengthening communications and developing trust and, as a result, reduce the likelihood of conflicts arising. These measures should be agreed during the transition phase:

- a one or two day workshop at the start of the contract with the key stakeholders;
- regular monthly measurement and reporting of performance, eg. providing timely identification of any issues requiring attention;
- regular quarterly reviews, eg. where senior management from both the purchaser and the provider attend and minutes are kept—chairing of the meetings can be rotated between the parties; and
- depending on the nature, complexity and criticality of the service, Steering Committees could be used as follows:
  - Management Steering Committee comprising two representatives from each party with the committee typically meeting, say, once a quarter; and
Contract Management

– Technical Steering Committee comprising representatives, as required, from both parties. The committee will typically meet once a month or more often as required.

A very important part of the relationship is the art or skill of negotiation. Negotiation is about open and frank discussion. Negotiation skills may be required to establish the expected requirements of operation or to get approval on a variation or to settle a claim. In all areas of negotiation the key points for managers are:

• be aware of the need for documentation of meetings associated with negotiations;

• obtain assistance from experienced negotiators and obtain appropriate training as required;

• before entering into negotiations, be prepared. Obtain information relating to the issues of all concerned parties, costing and performance data, client/stakeholder satisfaction measures and expectations regarding performance, legal assistance and advice;

• be clear about your objectives and the objectives of the provider. Understand what both sides have to offer;

• assess what is important to you and to the provider and assess who has the most to lose if things go wrong; and

• in a non-traditional relationship such as Partnering/Alliance, a ‘win-win’ solution should be sought, including the capacity to transfer and/or share risks.

The contract manager must ensure that the required delegated powers to negotiate have been given and are at the appropriate level. If a provider thinks that a contract manager can discuss and negotiate on a particular topic, but in fact cannot (or only a part of the whole topic), then the chances of agreement are slim. In such cases the view of the purchaser can be tainted for future meetings. Ensure at the start of the negotiation that the boundaries are very clearly spelt out.
Developing the transition strategy

Planning for the transition from one provider (often internal) to another (usually external) should commence as soon as the new provider is confirmed as the successful tenderer. As this is the period when participants first meet and the ground rules for the rest of the delivery term are set, the transition phase will determine the initial, and often the ongoing, attitudes and relationship for the contract period. During transition, the relationship will build and the expectations of the contracting parties and clients and stakeholders will crystallise. The transition strategy needs to:

- keep the focus on the changes required;
- facilitate appropriate resource allocation;
- undertake contingency planning (ie running ‘what if’ scenarios);
- facilitate open discussion on the service requirements;
- ensure full understanding of the needs and expectations of each party;
- set the rules for the rest of the contract; and
- outline all tasks to be completed with clear responsibilities for completing them.

Table 4 provides guidance on what needs to be considered during the transition phase and possible timeframes for resolution. These can be modified to reflect the size and complexity of the contract and its importance to organisation outcomes.
<table>
<thead>
<tr>
<th>Issue</th>
<th>Consider points</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industrial relations (IR)</td>
<td>It is important to identify whether the contract is likely to be IR sensitive and to identify what aspects of the contract are likely to be most sensitive to these issues.</td>
</tr>
<tr>
<td>Familiarisation period</td>
<td>For large and complex services a familiarisation period (e.g., six weeks) would allow the transfer of known data/documentation and knowledge and allow the provider time to recruit and train personnel, while the existing provider still provides the service. Commencement of services could be conditional upon satisfactory completion of the familiarisation period. For less complex contracts only a few days may be necessary.</td>
</tr>
<tr>
<td>Key personnel</td>
<td>The purchaser could provide assistance to the provider in the form of key personnel for a period of, say, three months. For corporate business support activities, such as cleaning, this may not be required at all.</td>
</tr>
<tr>
<td>Resourcing</td>
<td>The purchaser and provider need to resource up at this stage. The level of resourcing will depend upon the relationship chosen. Traditional relationships often have an expectation that the provider’s personnel, systems and methodologies will be in place on day one of the contract term. This can be a costly assumption and is often not considered during the tender stage. The relationship type will also affect the level of purchaser resourcing. Non-traditional relationships often require far more resources to set up, to implement during the transition period and to establish the appropriate relationships. The resource level after the initial phase should fall to a level below that of traditional arrangements as the relationship develops.</td>
</tr>
<tr>
<td>Transfer plan</td>
<td>Include transfer (or sale) of resources such as staff, equipment, systems and information. Consider the logistics associated with transferring staff (e.g., conditions) the physical relocation of assets, arranging on-site facilities and security of site and purchaser data (through systems access).</td>
</tr>
<tr>
<td>Records control</td>
<td>Consider not only the format and quality but a realistic timeframe for implementation and alignment of systems.</td>
</tr>
<tr>
<td>Alignment of business systems</td>
<td>Consider how to facilitate invoicing/payment processes, provider recruitment processes and purchaser involvement in recruitment processes.</td>
</tr>
<tr>
<td>Meetings (start-up &amp; ongoing)</td>
<td>A start-up workshop could include:                                                                 • explanation to both purchaser and provider personnel of their rights and obligations under the contract. In complex cases a lawyer could be used to confirm the provider understands the conditions;                                                                 • resolving cultural differences;                                                                 • purchaser/provider alignment; and                                                                 • payment regime based on milestones.</td>
</tr>
<tr>
<td>Occupational Health and Safety and security</td>
<td>Establish clear guidelines on OH&amp;S and security with the provider:</td>
</tr>
<tr>
<td>Identification of training needs</td>
<td>The competencies required of managers will depend on how critical the service is to the business and the nature of the relationship. The contract manager in traditional arrangements is often skilled in the area of the service delivery required only. This has come about due to the need to show the provider exactly what is required and how to deliver the service by giving direction on technical issues.</td>
</tr>
</tbody>
</table>
Further detail on specific transition issues can be found in Appendix 2. Ensuring that the issues listed in Table 4 are considered can be as simple as compiling a list of processes required in preparation for commencement. One means of facilitating this result is through the development of a procedural manual.

The procedural manual starts with the provisions of the contract and sets out the contract management processes to be used to meet the contractual terms. It should be prepared jointly by the purchaser and the provider during the transition period. Where the contract is significant in terms of size and/or complexity and is important to the delivery of outcomes, it is particularly important to ensure continuity, especially where there is a turnover of personnel within the purchaser and provider organisations.

Procedural manuals for traditional contracts tend to focus upon processes for payments, work scope, variations, cost control, quality assurance, reporting and practical completions in accordance with the control and compliance focus of traditional contracts. A manual for non-traditional arrangements should cover these and other issues required for managing contracts with more flexible and cooperative arrangements. Table 5 illustrates a typical table of contents for a procedural manual.  

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adapted from a better practice example at the Australian National University
### Table 5—Procedural manual—example of typical content

<table>
<thead>
<tr>
<th>Part of manual</th>
<th>Typical contents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Meetings and workshops</td>
<td>• schedule of meetings&lt;br&gt;• start up workshop&lt;br&gt;• monthly meetings&lt;br&gt;• quarterly reviews</td>
</tr>
<tr>
<td>Work scope</td>
<td>• brief description of scope&lt;br&gt;• how to vary</td>
</tr>
<tr>
<td>Variation order</td>
<td>• adjustment of prices</td>
</tr>
<tr>
<td>Cost control</td>
<td>• mechanisms and processes involved in cost control</td>
</tr>
<tr>
<td>Practical completion</td>
<td>• what defines practical completions&lt;br&gt;• delegates or approving officers</td>
</tr>
<tr>
<td>Quality assurance requirements</td>
<td>• records to be kept</td>
</tr>
<tr>
<td>Payment of invoices</td>
<td>• key dates&lt;br&gt;• format of invoices&lt;br&gt;• certification</td>
</tr>
<tr>
<td>Estimate request</td>
<td>• method of preparing estimates&lt;br&gt;• estimate guidelines</td>
</tr>
<tr>
<td>Work order</td>
<td>• process for raising work orders</td>
</tr>
<tr>
<td>Performance measurement</td>
<td>• collection of data&lt;br&gt;• evaluation of performance&lt;br&gt;• reporting of information</td>
</tr>
<tr>
<td>Reporting requirements</td>
<td>• specify requirements and obligations of both parties</td>
</tr>
<tr>
<td>Contract documentation</td>
<td>• how is it updated&lt;br&gt;• who keeps the original and receives copies</td>
</tr>
</tbody>
</table>

Appendix 3 provides a checklist for the appointment of providers to ensure that the key issues discussed above are addressed.
Preparing the resource plan

In order to facilitate an effective transition, both the purchaser and provider need to develop and agree on a resource plan. The resource plan quantifies the number of resources required for each major task, the timing of each and any specialist skills required for each person concerned. Resource requirements for traditional and non-traditional contract types vary because of the nature of the goods or services likely to be provided and depend on what the purchaser wishes the provider to deliver. Commonly, contracts require resources and systems to be developed by the provider (including quality procedures, data collection devices, reporting processes, claims for payment formats and complaints handling processes).

The resource plan needs to:

• identify the transition manager and a transition team. The team may not be required full time but, in the early stages, availability of the team is important to assist the provider gain a comprehensive knowledge of the business. The transition phase manager should desirably be the contract manager;

• identify the resources required to manage the transition phase and to assist with mobilisation, familiarisation and supervision;

• establish mechanisms for dealing with issues, complaints and disputes from both the purchaser and provider;

• establish contract management staff required for the term of the contract; and

• set a realistic transition time frame; this may be up to six months for more significant contracts.

The extent to which the resource plan needs to cover each of the above depends on the organisation’s assessment of the risks associated with the contract, its size and the complexity of the goods or services to be delivered.

The contract manager

One of the most important decisions will be the appointment of the contract manager. It is this person, in cooperation with the provider, who will have the opportunity to influence the success or failure of a contract. Depending on the risk assessment undertaken by the organisation, the time required to manage a contract may be full or part-time. In the purchaser/provider regime that is becoming more common-place in the public sector, it is likely that people who have never managed a contract are now required to do so in addition to their usual duties. It may also mean that the person managing a contract is not initially skilled to effectively undertake this new activity. Organisations need to provide managers with the opportunity to acquire the necessary skills and personal attributes to increase the likelihood of successful contract management.

The following is a list of factors to consider when looking for, and appointing, a contract manager. It also provides a checklist of possible training needs for new contract managers. Obviously, the mix of skills and emphasis on particular skills will need to vary to suit the specific contract requirements.
Table 6—Factors in determining the skills and attributes required of the contract manager

<table>
<thead>
<tr>
<th>Skills and attributes</th>
<th>Factors to consider</th>
</tr>
</thead>
</table>
| Experience            | • knowledge and experience of the organisation’s overall business  
|                       | • the level in the organisation the manager will hold |
| Technical skills      | • understands service elements  
|                       | • can specify variations  
|                       | • ability to appraise performance of service delivery |
| Management skills     | • experience/training in contract management  
|                       | • people management (contract management team and other staff)  
|                       | • skills in financial/cost management (budgeting, costing, asset management) and accountability framework |
| Communication skills  | • ability to present information in writing and orally  
|                       | • negotiation skills  
|                       | • facilitation skills  
|                       | • conflict resolution skills  
|                       | • networking, within the organisation and with industry peers |
| Personal attributes   | • interpersonal skills  
|                       | • flexibility  
|                       | • earns/maintains respect |

While individual members of a contract management team may specialise in managing only some aspects of service delivery, the team should establish knowledge management mechanisms to enable information and experiences to be shared.

It may also be that the contract manager and contract management team receive ongoing training and development over the course of the contract in line with their responsibilities. Networking with other contract managers can also assist in the development of personal skills and adoption of better practices. Whether formally (as part of membership of a professional body) or informally (at conferences), exchanging ideas and meeting with other professionals can be extremely useful.
Better Practice Example 3

Australian National University (ANU)—Policies to address training requirements in “Purchasing and Contracts Policies and Procedures”

The ANU’s “Purchasing and Contracts Policies and Procedures” includes a section on training of purchasing officers. The policies and procedures direct that officers should be able to do some or all of the following:

- identify and justify a requirement;
- plan a purchase and select the most appropriate methods;
- plan for and manage risks;
- develop a probity plan;
- develop evaluation criteria and an evaluation plan;
- develop tender request documents;
- seek quotations or tenders from the market;
- evaluate quotations or tenders;
- negotiate with suppliers; and
- manage contracts.

In addition, officers are advised to discuss their knowledge and skills requirements with their managers and seek training or development opportunities where the need arises.

Importantly, this section of the policies and procedures highlights the importance of contract managers being adequately trained and imposes a formal structure and obligation on all contract managers to address this requirement.
Post transition review

At the conclusion of the transition phase, it is important for the contract manager and provider to review the success or otherwise of the transition. The post transition review can be undertaken by using a scoring sheet for measuring satisfaction within the transition phase (e.g., using client/stakeholder surveys, holding a review meeting with the provider and key personnel and/or verifying milestones). In the rush to get a new supplier appointed, these feedback loops are often overlooked. The contract manager has a major role to play in this area. Future successes may be influenced by the contract manager’s ability to obtain and report relevant, factual and useful information on past successes and failures, including suggested improvements and any necessary corrective actions.

The post transition review report should be prepared by the contract manager and agreed with the provider. This report will serve as an important pointer to areas still incomplete or to any major problems outstanding. The report can also facilitate the adoption of better practices across the organisation in all contracts by highlighting the successes, failures and lessons learned in the transition phase.

Better Practice Example 4

Department of Communication, Information Technology and the Arts (DoCITA)—Comprehensive Contracts/Consultancy checklist

DoCITA developed and use a Consultancy Checklist to guide staff in the appointment of consultants. The checklist requires the contract manager to answer a series of questions and forward the responses to the Contracts Unit. The checklist assists in ensuring key contract management issues are addressed by staff including preparing the specification, selecting the consultant, evaluating offers and assessing performance. Each section must be answered, explanations provided for work not undertaken, and signed off by the Division Head before forwarding to the Contracts Unit.

The checklist assists effective contract management by focusing attention on matters of importance to the organisation, providing a formal reporting discipline for contract managers and their managers and ensuring consistent provision of information to the Contracts Unit for monitoring purposes. An example checklist developed from this Better Practice Example is provided at Appendix 3.
Part 2.2

Ongoing management of the contract

Introduction

This phase covers the life of the contract from the commencement to termination dates. Referred to as contract management, it is this phase that largely tests the success of the management of the contract, particularly management by the purchaser.

Once the contract is in place, risks become more focused, concentrating on the inherent contract management risks and the risks associated with inadequate performance of the provider.

The contract manager’s responsibility, during the ongoing management of the contract, is to ensure risks from both external and internal sources that were clearly identified as part of the risk assessment process referred to earlier, are managed to ensure effective delivery of the contracted service. That is, the treatments for these risks continue to be appropriate and operating effectively.

This Guide provides a framework for this ongoing management role. The extent to which any of the ideas discussed below are adopted depends upon the size and complexity of the contract, the assessment of the risks to organisational outcomes and the experience of the contract manager. One size does not fit all situations.

This Part also discusses briefly the impacts of dissatisfaction with contracted service delivery.

Objectives

The principal objectives of managing contract delivery are:

• developing service level agreements (SLA);
• managing performance based contracts;
• developing a performance management system (PMS);
• managing ongoing, day-to-day issues; and
• dealing with the possible effects of dissatisfaction with service delivery.

Outputs

The outputs of the ongoing management of service delivery are:

• SLAs established and documented as required;
• performance measures and reports;
• mechanisms for resolving poor performance agreed to; and
• mechanisms for documenting information control.
The following sections provide guidance on the establishment and maintenance of each of these aspects so that an effective framework is established that enables specific day-to-day issues to be managed promptly and efficiently and thereby avoiding risks to delivery. Examples of better practice in public sector organisations have also been provided to assist organisations.

**Developing service level agreements (SLA)**

Better practice suggests that service levels should be included in the tender documentation or negotiated during the tender/contract negotiations and included in the contract. One of the first steps in the ongoing management of the contract (whether performance based or not) is the development and documentation of these contracted service delivery standards in conjunction with the provider. This documentation commonly takes the form of a SLA. Depending on the nature and complexity of the contract, a SLA can range from being a simple one page list of standards through to a comprehensive schedule encompassing a number of agreements negotiated in detail with key clients and stakeholders. Contracts for non-complex/non-core services may not require a SLA, provided that performance levels have been adequately addressed in the contract documentation. Where the contract for services is more complex, and a SLA is required, the standards for service delivery should reflect the survey of needs that were established at the time of the initial purchase decision. SLAs should include:

- definitions of the work in measurable terms;
- the standards including quality, quantity and timeliness requirements; and
- descriptions of how the providers performance will be assessed against the standards.

Traditional contracts, with well-defined scopes, will tend to have clear requirements, outputs and service levels and therefore simple SLAs. With little scope for variation in deliverables, SLAs developed under traditional contracts tend to be categorised by a list of client and stakeholder requirements, processes to be undertaken and anticipated outputs. The measurement of service delivery is generally budgetary and either by progress or attainment of milestones.

Under non-traditional contracts, the use of comprehensive and detailed SLAs, and the ability to easily adjust them, improves performance and the measurement of performance.

Measurement and feedback on contract performance will be based on the SLA and span all areas of the delivery from the initial setting of the strategy to the final closeout and report on the actual delivery. Figure 7 shows the stages contained within the service delivery cycle.
Each component of the cycle has an impact upon the other. For example:

- the SLA cannot be defined until the precise tender statement of requirements have been established, agreed and documented;
- until the service level has been defined and agreed, the required resourcing levels cannot be determined and budgeted for;
- a set of business processes for the successful delivery of the service level will follow the allocation of correct resources and expertise; and, ultimately,
- it is unlikely a process will be followed if the people have not been adequately trained in that activity, or if they do not understand the process.

Once these factors are addressed and settled, the service outputs should meet the standards required. To make sure this is the case, a performance monitoring and measurement system is used to identify deficiencies and cases of excellence. Performance can then be evaluated by using external benchmarks. This information can then be assessed and fed into future decision making. Changes arising from such analyses can take the form of problem solving or process re-engineering, the outcome of which feeds into the requisite component that requires modification.
Better Practice Example 5

National Capital Authority (NCA)—Service requirements clarified in initial short term contract

The NCA used an initial, short term contract as a means of clarifying and testing the service requirements of a major IT contract before letting the long term contract. In this way the Authority was able to trial the performance standards and the operating arrangements before seeking feedback and inputting this into the process. Necessary changes can then be made in a timely manner. This approach is particularly useful when letting a high-risk contract for services close to core business with an unfamiliar provider.

One SLA may cover a number of key features including roles and responsibilities of the purchaser and provider as set out in the contract. Table 7 identifies the contractual obligations and how they translate to the service deliverables expected of both the provider and the purchaser.

**Table 7—Contractual obligations as part of the SLA**

<table>
<thead>
<tr>
<th>Sample of Contract Obligations</th>
<th>Provider Service Level Obligations</th>
<th>Purchaser Service Level Obligations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Term of contract and option to extend</td>
<td>Provision of services for three years</td>
<td>Option to extend for an additional three years subject to acceptable performance as assessed by purchaser</td>
</tr>
<tr>
<td>Supply of protective clothing and security</td>
<td>Equip provider employees with suitable protective clothing</td>
<td>Provide the provider’s employees with a photographic identity pass Ensure provider employees carry photographic identification</td>
</tr>
<tr>
<td>Rejection of service</td>
<td>Remedy any defects at its own cost by the time nominated by the purchaser (nominated in the contract/SLA)</td>
<td>Where the provider fails to satisfactorily remedy a defect, the purchaser may make alternative arrangements and recover the additional cost from the provider</td>
</tr>
</tbody>
</table>
Performance based contracts

As the services that are being contracted increase in size and complexity, organisations increasingly use performance based contracts. These contracts link part of the provider’s fee base to key performance areas and outcomes.

Commonly, the less complex the service to be delivered, the less incentive to innovate. More complex contracts closely link performance and quality of service to profit and rewards to encourage good performance. When the purchaser and provider agree to the use of performance based contracts, certain objectives must be in place for it to succeed. Table 8 provides guidance on developing performance based contracts.

<table>
<thead>
<tr>
<th>Objective</th>
<th>Methodology</th>
</tr>
</thead>
</table>
| **Alignment of purchaser/provider priorities** | • performance incentives that are aligned to the corporate strategy and direction of the organisation  
• clear identification of risk  
• flexibility to allow changes to incentives, key result areas, outputs and benchmarks during the term of the contract/agreement |
| **Incentives for improved performance** | • mechanisms that deliver mutual gain from achievement (ie. ‘win-win’)  
• incentives to achieve improved performance  
• incentives that add value to the purchaser’s business and are based on performance  
• incentives that are easy to administer and can be operated in a cost-effective manner |
| **Measurement methods that support performance improvements** | • results that are measurable and not based on perception only (subjectivity however, plays an important part in measurement)  
• established and agreed minimum performance (mediocrity should not be rewarded) |
Ideally, if the purchaser is able to establish and agree with the provider on the performance measures from the outset of the contract, the incentive scheme should then be negotiated during the tender/contract formulation period. A performance incentive scheme may apply after the first year or at the end of the original contract term in return for attaining high levels of service. A scheme may also commence in conjunction with granting an extension and/or continuance of the contract, thus providing a bonus in the form of continued service provision without the need for re-tender to obtain improved terms.

Alternatively, performance based contracts can include sanctions for non-performance, such as a percentage fee for late completion or flat rate for substandard levels of performance. It is important that contract managers pursue fair application of any sanctions in accordance with the contract and, where ‘trade-offs’ are used, they be appropriate to the objectives of the contracted goods or services.

Table 9 provides examples of performance incentives and approaches to implement. Further guidance to pricing and payment structures (e.g., cost plus, unit rate) can be found in Part 2.3 Pricing Structures.
### Table 9—Examples of performance incentives

<table>
<thead>
<tr>
<th>Forms of incentive</th>
<th>Possible approaches</th>
</tr>
</thead>
<tbody>
<tr>
<td>Extending the contract</td>
<td>If the original contract was for three years, an extension could be granted for an additional one, two or three years</td>
</tr>
<tr>
<td>For a project where time is critical, the provider is given financial incentive for completing ahead of time (or alternatively penalised for late completion)</td>
<td>Bonus payment amounts payable per day, week or month ahead of schedule (subject to quality checks of course)</td>
</tr>
<tr>
<td>Target costs established</td>
<td>Appropriate in an alliance relationship when the scope of services is broad and requires reimbursement at cost (established using an external benchmark). If the target is achieved, the ratio for shared savings may be on 50:50, 60:40 or an 80:20 basis</td>
</tr>
<tr>
<td>Part (usually 50%) or all of the provider’s potential profit placed at risk against achievement of performance</td>
<td>Appropriate when management fees are applied with ‘transparent’ pricing—alternatively, 100% of the provider’s potential profit may be placed at risk with an incentive of additional potential ‘bonus’ if performance targets are reached or exceeded</td>
</tr>
<tr>
<td>A reward at the discretion of the purchaser</td>
<td>SLAs linked to the purchaser’s strategic plan, would be used to measure performance, but not necessarily to the formal incentive—the bonus is then based more on total customer satisfaction</td>
</tr>
</tbody>
</table>
Escalation and savings

In establishing a performance based contract, organisations need to consider escalation or savings provisions. Escalation addresses the need for pricing increases over the term of the contract. In single year contracts, escalation is not normally necessary. In longer-term contracts, a facility for escalation is needed and a method of dealing with it adequately should be considered. Lengthy calculations or complicated formulas are not generally checked effectively, as time or other constraints and day-to-day pressures often apply.

As can be seen in Table 10, a traditional contract (ie. with a control and compliance focus) would generally be more suited to a 3 year contract using, say, the consumer price index (CPI) as the adjustment, as prices should be reasonably fixed and easily identifiable and caters for the changing market. Alternatively, the more flexible (cooperative, partnering and alliance) relationships are more suited to a longer term contract using actual costs as the basis of payment as the terms of such contracts are more likely to vary.

Table 10—Escalation provisions and relationship type

<table>
<thead>
<tr>
<th>Contract Type</th>
<th>1 Year</th>
<th>3 Years</th>
<th>5 Years Plus</th>
</tr>
</thead>
<tbody>
<tr>
<td>Traditional</td>
<td>fixed—no escalation</td>
<td>CPI adjustment</td>
<td></td>
</tr>
<tr>
<td>Cooperative</td>
<td>fixed—no escalation</td>
<td>cost</td>
<td>cost</td>
</tr>
<tr>
<td>Partnering</td>
<td>cost</td>
<td>cost</td>
<td></td>
</tr>
<tr>
<td>Alliances</td>
<td>cost</td>
<td>cost</td>
<td></td>
</tr>
</tbody>
</table>

Along with escalation, it is normal for the contract to provide for consideration of savings resulting from increased experience. Experience in the delivery of services may result in savings, eg. through reduced man-hours. It is common in cases where it is evident that efficiencies will be gained with experience to ask providers to state their savings per annum throughout the term of the contract, so that savings may be generated every year. Internal processes need to be in place to track and account for these.

The vertical axis in Figure 8 is typical of some private sector contracts where the providers nominate the increase in performance per year required for each year of the contract. This often results in a lower final year cost than starting year cost, even accounting for inflationary aspects of the general economy. The gains in performance over time in this example (shown left to right) more than make up for the increase in costs, resulting in a lower final year cost than in the initial year.
Figure 8—Escalation or savings

Performance Measurement System (PMS)

The contract manager is responsible for ensuring measurement and monitoring of actual performance in relation to the planned or desired performance as outlined in the performance based contracts and SLAs. In order for the contract to be monitored, a performance management system (PMS) should be developed and applied to monitoring of service levels. The extent of the PMS and the effort required to establish it depends on the size and complexity of the contract and the number of contracts being managed by the contract manager. The PMS should recognise the dependencies between the performance of the provider and purchaser. Consideration should be given in the PMS to the impact of the performance of the purchaser on the providers. As with any relationship, success is a result of the efforts of both parties. The PMS seeks to provide a monitoring framework by which the contracted services will be measured and should, where circumstances suggest, comprise:

- a commercial contract defining the commercial and business relationship;
- a procedural manual containing instructions on how to perform the services;
- a SLA detailing the standards for each service;
- appropriate and effective methods for measuring and monitoring performance;
- targets aimed at continuous improvement;
- components to measure continuous improvement;
- timely problem solving; and
- reporting documents that, through graphical, pictorial and/or descriptive means, demonstrate adequately the achievement of the service levels in the contract and SLA.
The following sections address, through suggested frameworks for implementation and better practice examples, how to undertake the last five points above. Part 2.1 of this Guide provides guidance on how to prepare a procedural manual. The first section of Part 2.2 deals with the establishment of SLAs. This Guide does not deal with how to prepare the actual contract. The introduction to this Guide provides some pointers to other documents that may be useful in preparing the contract.

**Measurement and monitoring**

To be effective the method of collection should not become a whole system in itself. Continuous monitoring does not mean overseeing the provider by checking everything they do. It can mean monitoring the exceptions and leaving the actual measurement of performance to the provider(s) or using external auditors to review performance. To employ checkers simply to check on the service provider would be a retrograde step.

To be appropriate, a measure should be based upon metrics (ie the actual measurement of data, before being interpreted and reported) that are directly derived from the service. If that type of direct measure cannot be applied, some other appropriate measure would have to be identified. Costs and progress get measured and monitored because they are captured and they are commonly the focus of management reviews in traditional arrangements. These criteria can be wrongly used as a performance indicator. Table 11 illustrates some measurement issues to consider.
Table 11—Measurement issues and approaches

<table>
<thead>
<tr>
<th>Measurement issue</th>
<th>Possible approach</th>
</tr>
</thead>
<tbody>
<tr>
<td>Measurement</td>
<td>Measures may be: physical—number of items, area covered, amount of supply, volume, relational—margins, turnover rates, cost-based—unit costs, margins, waste</td>
</tr>
<tr>
<td>Periodical reviews</td>
<td>The period of review would normally be set at the same time as the development of the statement of requirements because measurement timing will need to be appropriate to the type of service being measured</td>
</tr>
<tr>
<td>Updated and revised as needs change</td>
<td>Evolving performance indicators over the life of the contract should be encouraged—this means the approach to measurement may also need to change. Often performance indicators that are set at the start do not evolve with the contract. While they may be appropriate at one time in the life of the contract, as any rework frequency declines (which it generally will if linked to reduced earnings by the provider) then the continual monitoring becomes wasteful. In such circumstances managers must look at other areas of delivery that need measurement and negotiate adjustment to the reward systems accordingly</td>
</tr>
<tr>
<td>Problem solving using benchmarks</td>
<td>This comes from two sources: • internal (the contract manager)—measurement over time demonstrates whether the internal systems are improving, getting worse, or stagnating; and • external sources—where the organisation compares their performance with that of external bodies Periodic monitoring of these two sources will show a trend that captures the efficiency and effectiveness of the operation</td>
</tr>
</tbody>
</table>
A PMS for a traditional, controls-based contract will naturally be more structured and rely primarily on the contract manager to maintain performance information and to provide feedback to the provider. A contract manager may collect performance information through the following:

- a database recording time spent on delivery of goods or services and milestones reached;
- hotlines or registers to record feedback, particularly complaints or exceptions in service delivery;
- inspections by the contract manager or an independent expert, eg. of premises to ensure they are clean and safe; and
- checklists completed to ensure all tasks have been completed.

If a contract manager is managing a partnering or alliance contract where performance measurement is based more on trust, cooperation and risk sharing, the PMS will rely more on the provider to self monitor their levels of service delivery. It generally will be in the provider’s interest to maintain high levels of service delivery and they will be expected to work closely with the contract manager to ensure they are achieved. The contract manager will need to be assured the provider has sufficient quality assurance processes in place to adequately monitor work undertaken and may use financial incentives to encourage self-compliance.

A contract manager of a traditional contract may require ongoing client feedback to monitor the provider’s performance, for example through a complaints hotline. A contract manager of a partnering or alliance contract may use only ad hoc surveys to provide an independent verification of the provider’s performance data, relying on the provider’s data for day-to-day management decisions. Feedback to the provider can be facilitated through regular review meetings to discuss the feedback against the performance measures and requirements of the contract. Where a contract manager is responsible for a number of large, complex contracts to deliver a single product or service, independent verification of quality may be used. This will help alleviate the amount of administration required to ensure standards are being met.

Continuous improvement and benchmarking

If every service is split into its component parts and each of those parts is then measured, then any decline or improvement in the service delivery can be monitored and corrective action taken.

Table 12 is an example of continuous improvement. Changes in productivity are an indicator of the efficiency of the operation. The equipment and materials usage will increment by inflation, as will the labour charges, but at the same time output improves. Often continuous improvement is requested as part of the tender statement of requirements and therefore the contract manager will need to develop a process, in conjunction with the service provider, to monitor performance.
Benchmarking can also be used to measure progress for any goods or services and can be internal or external. Internal benchmarking focuses on measuring performance against internal goals or other areas of operation while external benchmarking measures contract performance against the performance of services in other organisations. The latter will often depend on identifying appropriate benchmarking partners particularly on the aspect of performance being benchmarked as opposed to those producing similar goods or services. However, care needs to be taken over what is measured and the selection of the measures that are used to indicate the level of performance. Benchmarking provides an insight into different levels of performance and is indicative only. It should not be used in a definitive manner.

**Standards**

Standards should be developed against which performance can be compared. Generally these standards will be written in terms of cost (or efficiency), scheduling and service quality. The standards may be expressed in absolute terms or within a specified acceptable range, or by participants rating service quality and expectations. It is essential that performance criteria relate service to quality as well as cost.

Measurement of key performance indicators (KPIs) should add value to the procurement process. KPIs should preferably be measurable statements describing actions or events related to cost, time, quality and service with attributes that are verifiable, relevant and unambiguous.

Quantitative measurements are easier than qualitative or judgemental ones, although in some circumstances, such as evaluating service performance, more subjective criteria may be the only ones able to be used. The latter may come mainly from survey data.

**Table 12—Measuring continuous improvement by benchmarking**

<table>
<thead>
<tr>
<th>Item</th>
<th>Period 1</th>
<th>Period 2</th>
<th>Period 3</th>
<th>Period 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Allocated hours for service delivery—</td>
<td>4000 Hrs</td>
<td>3950 Hrs</td>
<td>3900 Hrs</td>
<td>3890 Hrs</td>
</tr>
<tr>
<td>(Labour hours)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Service Delivery Materials/Software</td>
<td>$ 70 000</td>
<td>$ 69 000</td>
<td>$ 69 000</td>
<td>$ 70 000</td>
</tr>
<tr>
<td>Service Delivery Equipment/Computers</td>
<td>$ 25 000</td>
<td>$ 25 000</td>
<td>$ 25 000</td>
<td>$ 25 000</td>
</tr>
</tbody>
</table>
Defining quality

Quality performance measurement is perhaps the most difficult aspect of contract management. The task can be made easier by defining quality as ‘conformance to requirements’. A product or service either meets its requirements or it does not. However, before quality objectives can be met, requirements need to be accurately specified and communicated to the provider. Service quality is best determined by establishing which attributes of the service are considered important and how well they should be performed.

Measures of service quality and satisfaction

The following two models have been developed for measuring consumer perceptions of service quality and satisfaction. The first model identifies the major dimensions on which service can be measured.

Table 13—Measuring service quality

<table>
<thead>
<tr>
<th>Item</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tangibles</td>
<td>The physical facilities, equipment, appearance of personnel and the presence of other participants</td>
</tr>
<tr>
<td>Reliability</td>
<td>The ability to perform the promised service dependably and accurately</td>
</tr>
<tr>
<td>Responsiveness</td>
<td>Willingness to help participants and to provide prompt service</td>
</tr>
<tr>
<td>Assurance</td>
<td>Knowledge and courtesy of staff and their ability to convey trust and confidence</td>
</tr>
<tr>
<td>Empathy</td>
<td>Caring individualised attention to participants</td>
</tr>
</tbody>
</table>

12 Fiona Colburt, Martin Dutton and David Hurrell, Contract Management, BRWMTS Group, Balgowlah, April 2000
The second model measures consumer satisfaction and matches the perceived service with expected service.

**Figure 9—Measuring service satisfaction**

**Targets**

Performance targets should be achievable and agreed in consultation between all stakeholders, including the provider.

Targets should be temporary if continuous improvement is the aim. To fix a target (as being the best or what we want) effectively eliminates the possibility of even better performance. Managers will need to review the effectiveness of any target (for all the items being measured) and whether they should continue to be measured. This should be done at regular intervals depending on the service. Regular review of targets provides assurance that the targets are still relevant to the goods and services to be provided as well as giving feedback on progress against the targets in an ongoing manner. This will provide the contract manager with early identification of inappropriate targets as well as highlight any difficulties with achieving targets in a timely manner.

Benchmarking is also an effective means of testing targets to ensure organisations are aiming for the best possible level of service delivery.

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If this is the first use of a provider, the performance measures may take months to settle down (this depends on the level of service complexity and the learning curve of both parties). Following this, a period of stability is normally achieved often due to the achievement of a ‘target’. Table 14 provides some suggested performance indicator review points for various activities.

**Table 14—Suggested performance indicator revision/monitoring periods**

<table>
<thead>
<tr>
<th>Service</th>
<th>Frequency</th>
<th>Type</th>
</tr>
</thead>
<tbody>
<tr>
<td>Grounds maintenance</td>
<td>Three Months</td>
<td>Visual inspections and client and stakeholder surveys</td>
</tr>
<tr>
<td>Lift inspections</td>
<td>Six Months</td>
<td>Independent reports, client complaints, logged problems</td>
</tr>
<tr>
<td>Paper delivery</td>
<td>Every 50 000 reams</td>
<td>Client and stakeholder surveys</td>
</tr>
<tr>
<td>Professional consultancies</td>
<td>Per milestone</td>
<td>Attitude measures, responsiveness measures, deliverables measurement (quality and quantity)</td>
</tr>
<tr>
<td>Travel contracts</td>
<td>Monthly</td>
<td>Service surveys</td>
</tr>
</tbody>
</table>

**Problem solving**

Problem solving (also called root cause analysis) endeavours to establish the root cause or reason for failures or successes. Having identified (either by benchmarking or other such measurement) current performance levels, the organisation will need to establish the reason behind any failures in order to reach the agreed service levels. Problem solving is a process by which cause and effect activities and/or outputs are systematically analysed until a root or source has been identified. Corrective action can then be taken to remedy the exact cause or problem identified sooner rather than later.
Performance reporting

In order to effectively monitor progress of the contract, the contract manager needs to establish a reporting regime that matches the nature and complexity of the contract being managed, in order to monitor effectively the performance of the provider. The contract manager should acknowledge the impact that the performance of the purchaser has on the provider and adjust information presented in performance reports to reflect this dependency.

To facilitate timely and accurate reporting on service delivery the contract manager should consider, in conjunction with the provider, the following issues in relation to the reporting document:

- The method of delivery of reports and what format they should be provided in. With so many systems available, each being able to produce information in a variety of formats from hard copy through various software types, it is important to ensure the transmittal medium is appropriate and effective. Will the types of computer models used today still be able to read your files in 10 years time or is there a cost for updating them and keeping up with the technology of the day? Are hard copy invoices more appropriate?

Better Practice Example 6

Root cause analysis Supermarket Scanners*

For years, the point of sale price scanners at a supermarket had periodically stopped working, requiring operators to manually key in barcodes. Every time a failure occurred the central logging system registered a fault and placed a “next visit” service call for their maintenance provider. Several tests had to be run, but it transpired that the fault was caused by a combination of events. Firstly, some goods, such as breads, were not in sealed bags, thus allowing flour dust, etc to get onto the scanning surface. Secondly, the solution the cleaners used to clean the surface was inappropriate. Thirdly, the scanner surface comprised two layers of glass with a small air gap, into which the waste from the cleaning solution and the product particles could pass. Disassembly, cleaning and re-assembly due to a service call would alleviate the problem temporarily. The cause therefore was that the glass units were not sealed. The solution was to install sealed units. Replacement of the units resulted in productivity at the checkouts increased (by monitored scan rate) by 15% overnight.

*Example provided by Currie & Brown
• The regularity of reporting. The provider may be asked to issue high level summary reports on a monthly basis for use by executive management, with weekly reports on the more detailed data. The decision on what to provide should be based on the needs of the parties receiving the reports. Suggested types of reports have been provided in the list below. It is the responsibility of the contract manager to discuss reporting timings with those parties and then agree this with the provider.

• Who will provide the analysis? Reporting is not just about collecting data but is about providing information. For reports on the performance of the provider to be useful they need to be presented in a way that allows easy comparison to the contract. They should include, where possible, simple and straightforward analysis of any relevant benchmarking information and performance over time.

• Ensuring the quality of the reporting documents. It is the contract manager’s responsibility to monitor the quality of the information submitted by the provider as well as the information to be presented to executive management, clients and stakeholders.

• Ongoing relevance. It can be a temptation for both contract managers and providers to present too much rather than too little information. More is not always better. Too much information is a waste of resources in preparation time for the provider and checking time for the contract manager. Contract managers need to always be looking at the information provided and testing its relevance against the information they need in order to assess the performance of the contract. If the information needs of the provider or contract manager change, the reporting framework should be responsive enough to not only recognise the need for change, but also to adapt to providing the new information requirements.

Reporting documents include:

• performance management information—particularly instances of very good and very poor performance;

• achievement of milestones or progress against the timeframe for the contract;

• client feedback—particularly exceptions;

• action taken to address problem areas and whether successful;

• variations to the SLAs or contract; and

• financial progress against the contract.
Purchasers should ensure they preserve those records, including performance reports, which are needed to support the delivery of business outcomes and to meet their accountability and archival responsibilities. In particular, care should be taken with electronic records. Organisations must manage electronic records with the care they manage paper records and in accordance with the requirements of the Archives Act 1983. The National Archive of Australia has issued a new standard in record keeping called e-permanence which provides practical guidance on the design and implementation of best practice record keeping systems to deal with the challenges presented by the new electronic environment.

**Day-to-day ongoing management matters**

While managing performance based contracts, defining SLAs and establishing a PMS provides the framework for contract management the matters discussed in the rest of this Part of the Guide are the day-to-day, hands-on issues to be dealt with. The following actions should promote successful contract management:

- the contract manager has the full support of senior management and the resources to do the job;
- the manager is familiar with the activity and the process from which the contract arose;
- the manager has the requisite skills or is being trained in contract management and any specialist skills required;
- the manager has sufficient authority for day-to-day management;
- the organisation has a relationship of trust with the provider;
- a flexible attitude is taken to contract management; and
- the contract management team learns as it goes, to improve continuously the possibility of a successful contract.

Issues such as documentation, information systems, issue resolution, variations and payment processing are the day-to-day, ongoing management issues of the contract management process, and as such must be clearly defined and agreed. Issues such as documentation, information systems, issue resolution, variations and payment processing are the day-to-day, ongoing management issues of the contract management process and, unless clearly defined and agreed, have the potential to considerably disrupt service delivery.

The following sections provide guidance on the establishment of a structure to assist contract managers in the effective monitoring and management of these matters.
The success of a contract may very well depend on the accuracy and credibility of the information recorded. Therefore, it is important to maintain and review the information gathered and keep it organised and user-friendly for easy and reliable access.

For public sector purposes it is also important to keep appropriate records to demonstrate that ethical standards have been observed, that money has been well spent and that decisions can be sustained through any administrative or judicial review.

Managers need to ensure that the contract deliverables are actually being delivered. This can be difficult as a provider may be asked to submit a mass of information that detracts from the provision of those reports that are really useful. Most commonly this is due to the tender statement of requirements being a combination of all previously requested information plus new ideas.

Better Practice Example 7

Royal Australian Mint
DoCITA—Centralised contracts unit

One means of providing expert advice to contract managers, monitoring contract management across the organisation and encouraging the dissemination of better practice and continuous improvement is through the establishment of a central contracts unit or central contracts officer. The ANAO noted two organisations, DoCITA and the Royal Australian Mint, which had used this as an effective tool in contract management. They were able to:

• provide a single contact point for staff seeking advice on contract management;
• facilitate the dissemination of consistent policies and practices;
• provide a central point for monitoring contract management of all contracts regardless of size; and
• draw together better practice examples and encourage continuous improvement across the organisation.

The Joint Committee of Public Accounts and Audit Report 379 on Contract Management in the Australian Public Service (October 2000) also suggests that organisations consider the use of central purchasing units to ensure there is a source of appropriate experience to draw upon.
This problem can arise as a result of managers providing limited relevant feedback at the end or during the term of a contract. In order to furnish input on what is and is not required, the purchaser needs feedback from both the users of the information and the providers of the service.

All processes for engaging and managing providers must be fully documented in a specific file for each contract. At the very least the contract manager must keep the following documentation:

- the justification (Needs Identification) for using a provider;
- approval to proceed;
- tender documentation;
- details of the selection process, including reasons for the choice of successful provider(s);
- a complete set of the contract documents kept in a central file;
- copies of the transition strategy, procedural manual and resource plan;
- copies of performance reports. Copies of all decisions made related to provider performance, including all written directions, requests, reports and letters sent to the provider and their responses and records of oral communications relating to the above;
- payment details;
- records of meetings; and
- a copy of the agreed succession plan.

The need for this level of relevant documentation is twofold. It enables the contract manager to effectively manage issues emerging on a day-to-day basis and provides a sound basis for re-tendering the services at the end of the contract, if appropriate to do so.

In designing the contract and accompanying documentation, three guiding principles to remember are:

- Purpose—try to make the point and outcome from each document explicit;
- Clarity—use plain English to keep concepts concise and clear; and
- Priority—emphasise first things first.
Better Practice Example 8

National Capital Authority (NCA)—Minimum standards for contract documentation

The NCA’s Financial Management and Administration Manual provides direction in relation to documentation requirements. The manual provides contract managers with a minimum required level of documentation including:

- the justification;
- initial approval;
- details of the specification/terms of reference;
- details of the selection process;
- a copy of the contract and correspondence on any changes to the contract;
- a copy of the evaluation report on provider performance; and
- payment details.

The manual also states that a register for consultants will be maintained which will include:

- a list of all consultants currently and previously engaged;
- file references for documentation relating to each engagement;
- contract details for each consultancy;
- providers area(s) of expertise and experience; and
- a brief assessment of satisfaction with services provided.

A register such as this provides a centralised reference point for monitoring consultancies in progress and ensuring an assessment is undertaken at the completion of the consultancy.
Information systems

One issue that contract managers face is maintaining the information needed by the purchaser to carry out a number of functions such as benchmarking, measuring or assessing continuous improvement, quantifying failures and specifying achievement of objectives.

The use of a single information system allows the physical recording of the data to become the provider’s responsibility and frees contract managers to focus mainly on spot checking. When developing, selecting or implementing a central service measurement system, it is important to consider the following:

- common documentation and systems—common documentation and systems facilitate analysis and prevents time wasted in re-entering data; and
- intellectual property clauses—the contract manager should control all information issued to the provider and ensure its return at the conclusion of the works. Protection and ownership of intellectual property is an issue in some types of arrangement.

Better Practice Example 9

Australian Geological Survey Organisation (AGSO)—Computerised management information system

AGSO implemented a computer based project/contract tracking program to improve the management of contract information. The system was developed over three years by a team of consultants and prepared to AGSO’s specifications.

The system was introduced to identify costs on a project by project basis. The system also enables further categorisation by dividing projects into activities.

The system is updated by service providers but reports can be generated by the contract manager in order to monitor, review and assess performance against agreed criteria and standards.

Issue resolution

During the contract management phase, issues in dispute may emerge on a regular basis. For those matters minor in nature and having minimal impact on the outcome of the contract, the contract manager should attempt to resolve these through discussion with the appropriate parties in a timely manner. E-mail can be a useful mechanism for informal discussions of such matters as well as providing written evidence of the issues raised and solutions agreed. However, as with all electronic data, e-mails need to be managed in accordance with the requirements of the Archives Act 1983.
Some disputes however may be of a more serious nature and much more difficult to resolve. In order to facilitate timely resolution the contract manager should:

- identify and clearly describe the issue of contention and the key clients and stakeholders involved;
- establish suitable communication between the key clients and stakeholders to assess their concerns;
- document the matters raised with options for solutions;
- facilitate agreement on corrective action and implement as quickly as possible; and
- follow up in a timely manner to ensure the corrective action was successful.

In the case of conflicts unresolved after negotiation, contracts should have specific formal dispute resolution procedures and a process of mediation and/or arbitration. However, an issue resolution process should be applied before remedies are sought under the contract, such as contract termination.

The following issue resolution process is modelled on a better practice example at the Australian National University.

### Better Practice Example 10

**Australian National University (ANU)—Issue resolution process**

<table>
<thead>
<tr>
<th>Level</th>
<th>Process</th>
</tr>
</thead>
<tbody>
<tr>
<td>Initiation</td>
<td>Record all issues and notify the provider; giving details of the issue</td>
</tr>
<tr>
<td>First</td>
<td>Within an agreed period (depending on the criticality of the services, say 3–5 days) the contract manager and the provider’s representative should attempt to resolve the issue. It is important that both representatives have the necessary authority and information to resolve the issue</td>
</tr>
<tr>
<td>Second</td>
<td>If the issue is not resolved within an agreed period, eg. 5 days, then the issue should be escalated to the next level where the contract manager and the provider attempt to resolve the issue</td>
</tr>
<tr>
<td>Third</td>
<td>If the issue is not resolved within an agreed period, eg. 10 days, then the issue should be escalated to the next level where the CEO and a Director from the provider attempt to resolve the issue</td>
</tr>
<tr>
<td>Arbitration</td>
<td>If the issue is not resolved within an agreed period, eg. 21 days, then the issue will become a dispute under the contract and be submitted to arbitration</td>
</tr>
</tbody>
</table>
The issue resolution process, which should be confirmed with legal advice, could be included in the contract and expanded on in the SLA. Formal processes are unlikely to improve service delivery and are not designed to resolve day-to-day issues. It is important that, where there is a dispute, the purchaser and provider must continue to perform all obligations under the contract and ensure services from the provider are not disrupted. The contract should allow the purchaser to engage another provider in the event that performance is not satisfactory or services are not being provided while in any dispute.

Better Practice Example 11
Royal Australian Mint (the Mint)—Comprehensive dispute resolution clause

The Mint includes in its standard contract a better practice example of a dispute resolution clause. Importantly, the clause highlights the issue of dispute resolution and formalises a process for addressing the issue that is legally binding on both parties. The process provided is hierarchical and simply and clearly presented with a concluding option for mediation. The clause provides for the provider to continue working on the contract until the matter has been resolved.

Variations

One of the roles of contract managers is the control and processing of variations to the contract. The contract manager will need the authority and a flexible approach from which change can be based. They may need to negotiate such matters as price, the standards to be delivered and a timeframe for actioning. The contract manager will need enough information to be able to negotiate a fair price, agree whether standards are realistic and reflect client expectations and set a realistic timeframe for application. Being prepared for negotiations can take considerable effort in, for example, clearly defining the change, establishing a market price using industry experience and confirming client/stakeholder expectation.
The approach taken for the variation(s) depends on the form of contract used for the service delivery and is summarised by relationship type (see Table 15). Under a traditional contract (that relies on control and compliance), variations will tend to be fully scoped with pricing established before the work is undertaken. In alliance and partnering relationships (based on a more flexible and cooperative working approach), variations may be less structured, for example with invoices provided after the work is done and based on an initial agreed cost structure. Renegotiating the initial contract to accommodate variations is likely only to be necessary for significant changes to the original scope.

### Table 15—Link between variation approach and relationship type

<table>
<thead>
<tr>
<th>Variation approach</th>
<th>Traditional</th>
<th>Cooperative</th>
<th>Partnering</th>
<th>Alliance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Type of change</td>
<td>fully identified and scoped</td>
<td>fully identified and scoped</td>
<td>not necessarily fully identified and scoped</td>
<td>for significant change to scope only</td>
</tr>
<tr>
<td>Method of obtaining price</td>
<td>similar to a single point tender</td>
<td>similar to a single point tender but with closer relationship</td>
<td>possibly at “cost”</td>
<td>possibly at “cost”</td>
</tr>
<tr>
<td>When to obtain price</td>
<td>prior to starting the works</td>
<td>prior to starting the works</td>
<td>possibly at any time if paying cost</td>
<td>possibly at any time if paying cost</td>
</tr>
<tr>
<td>Competitive rates</td>
<td>probably not</td>
<td>possibly, depends on relationship</td>
<td>probably yes</td>
<td>probably yes</td>
</tr>
</tbody>
</table>

Renegotiating the initial contract to accommodate variations is likely only to be necessary for significant changes to the original scope.
Regardless of the type of contract and relationship established, the contract manager should consider the following matters in establishing an effective variation processing over the life of the contract:

- an upper dollar limit in the contract for variations to prevent a contract being agreed and approved for a small task and then being changed drastically to address a totally different need;
- a standard contract variation form that provides for changes in the price, quantity, timeframe and appropriate authorisations;
- authority levels to match variation levels, e.g. contract managers can approve up to 10% of the contract price in variations. All other variations to be approved by executive management;
- amendment of the PMS to include monitoring of contract variations; and
- maintenance of a contract variation register to monitor the numbers and types of variations proposed and agreed.

Contract managers need to monitor the type and number of variations made against a contract. If a large number of variations is made to a contract, this may be because:

- the wrong contract relationship was established (for example traditional rather than partnering);
- the SLA and contract service specifications were poorly or incorrectly stated;
- problem solving or root cause analysis was not undertaken; and/or
- the wrong provider was chosen.

It is important if any or all of the above has occurred that the contract manager identify the issue and take remedial action immediately to ensure the continuity of the business. Further information on business continuity planning is available in the ANAO Better Practice Guide, Business Continuity Management (January 2000). In some situations it may be appropriate to develop updated contract documentation, incorporating any variations made previously.

**Payment processes**

Before payment to the provider can be approved, the contract manager needs to be satisfied the work has been completed in accordance with the contract and SLA. The PMS and reporting documentation, discussed earlier in this Guide, play an important part in providing that assurance to the contract manager.

In addition, delegations and authorisations play a crucial role in Commonwealth contract management. For example, in relation to each procurement activity, an appropriately authorised person must approve a proposal to spend public money in accordance with the Financial Management and Accountability Act 1997, including Regulations 9, 10 and 13. In most organisations, authorisations under the Chief Executive Instructions need to be complied with as well as requirements of other legislation such as the Land Acquisitions Act.
It is important the contract manager agree:

- the processes for payment to the provider, eg. will payment be a regular monthly instalment, a cheque delivered in response to an invoice or electronic funds transfer (EFT). Increasingly, organisations are adopting EFT as cheque preparation is becoming more costly. EFT has the added advantage of avoiding cheque clearance periods;

- the format of invoices, eg. electronic or hard copy, mailed or delivered in person and how much information is provided. Providers should be encouraged to develop electronic invoices that can be electronically added to the payment system, particularly when the Commonwealth is providing such a facility from July 2001;

- the timing of invoices, eg. it is preferable to send invoices at the beginning of the month to ensure the minimum time between sending the GST amount to the Australian Taxation Office (ATO) and receiving payment from the supplier. This should be done because Business Activity Statements (BAS) are prepared at the end of the month, at which time Goods and Services Tax (GST) becomes payable. The use of EFT would facilitate this approach;

- the establishment of a minimum level of information to be included in invoices; and

- what checking will be undertaken before invoices will be paid, eg. will the contract manager be solely responsible for checking the contract, SLA, and/or the PMS in order to be satisfied the goods or services have been delivered satisfactorily.

These details can be included in the procedural manual developed during the transition phase and are discussed further in Table 16.

Traditional contracts will generally rely on detailed checking of invoices and performance information in line with their control and compliance focus. Provider checking of invoices is becoming the norm in partnering and alliance contracts where trust levels are higher and the relationship is based on a sharing of risks and a cooperative approach. The effort to check every part of the contract in the invoice period can be non-productive in this environment. The information to be included in invoices and the level of checking required should be based on a comprehensive risk assessment that includes identification and management of risks associated with all contract processes.
Historically, this has not been dealt with in the contract and it has been left up to the contract manager to sort out. This is not better practice. Formal communication should form a part of the statement of requirements. Appropriate feedback requirements from the contract manager should be embodied in the tender statement of requirements.

As above, these specifications are often not included in formal contract documentation. These specifications should however be agreed upon and included in the contract.

The procedural manual (discussed earlier in this Guide) should determine the most appropriate form of medium to be used. Electronic copies are becoming the norm but hard copies of original documents should be safely stored in the event of electronic corruption. Increasingly, organisations are adopting EFT as the preferred payment mode as a result of cost efficiencies gained.

Possible effects of dissatisfaction with the delivery

To appoint a provider and then to manage the contract on the basis that if the provider does not comply with the contract, the purchaser can terminate it is not good management. This approach can add to cost in several ways:

- costs of termination;
- potential court and legal costs;
- costs of re-tendering; and
- costs of temporary measures to ensure delivery and the cost to the organisation either monetary or publicly in any failure to achieve their objectives.

Processes therefore need to be discussed with the provider and fine-tuned to ensure the best possible chance of successful completion of the contract.
Dissatisfaction is commonly due to a number of factors, such as the following:

**Needs/Wants**, e.g. the number one priority to you as a user of the service may not be reflected in the contract at the level you require; or the on-going responsibility for timing and overall delivery of the service is left wholly to the provider.

**Resistance to change**, change may concern people and resistance to it is common. The effect, in the first instance, is usually to undermine confidence and later to introduce (depending on authority levels) new providers.

All of these concerns can and should be, addressed quickly. The contract manager needs to be on the lookout for such signs. This can be achieved by survey, face to face discussions, or open forums, so that the most appropriate level of service is being provided.

Dissatisfaction about service delivery can manifest itself in the use of supplementary providers. Staff disappointed with the provider’s service delivery may seek out and employ alternative service providers, particularly where service areas within an organisation have control over the budgets and expenditure. Simple examples of this practice have been observed in maintenance works and have added 10% to the cost of the combined delivery. In effect, services are being paid for twice. The contract manager needs to be vigilant in preventing this situation arising. Figure 10 demonstrates how the additional costs can occur.
Communication and measurement of client/stakeholder satisfaction will give signs of impending issues. Extra effort will then be required to take corrective action and avoid unnecessary costs to the organisation.

Figure 10—Effects of using multiple providers\textsuperscript{14}

Effect of Single Source Use Plus Supplementary Providers

\begin{itemize}
  \item Supplementary service costs
  \item Supplementary provider profit
  \item Supplementary overheads and profit
  \item Original provider service costs
  \item Original provider profit
  \item Original provider overhead
\end{itemize}

\textsuperscript{14} Figure provided by Currie & Brown
Part 2.3
Contract succession

Introduction

This phase of the contract management lifecycle looks at ensuring a smooth succession phase at the end of the contract period to ensure minimal impact on the business of the organisation. The number of issues at this stage and the effort required to manage them, will depend on the nature and complexity of the contracted service.

The contract succession phase, which may commence before the contract is completed, also involves a review of the successes and failures that occurred over time in the contract arrangements. It is particularly beneficial to establish whether the issues that arose resulted from difficulties with the initial tender specifications or the signed contract itself (including the form of relationship that resulted from the contract and the pricing regime put in place).

This phase may involve undoing all the arrangements previously in place to allow for a completely new service provider to take over, or to bring the service delivery back in-house if that is feasible. Whatever the succession proposal, the resource commitment necessary will likely be similar to that involved in the initial transition phase.

Experience has shown that most problems with contracted service delivery occur because of an inadequate transition phase that lead to misunderstandings about the deliverables. This situation may then be exacerbated by the manner in which the contract relationship is managed.

The succession phase is therefore about learning lessons and establishing a clearer understanding of what makes contract management successful. These lessons will then form the basis of the planning, tender requirements and negotiations for the next contract. This Part of the Guide looks at options that address some of the issues that can arise in contract service delivery.

Objectives

To ensure that there is a smooth, efficient and effective transition at the end of the contract for either an extension of the existing contract with any revised service levels, for selection of a new provider or for returning the services to in-house provision.

Outputs

The organisation should have:

- a preferred relationship type and pricing structure selected; and
- an agreed succession plan.
Evaluation

This stage of contract management deals with:

- evaluating the outputs and outcomes of the contracted activity against tender requirements;
- assessing the effectiveness of the contract in achieving government objectives for the activity;
- assessing effectiveness through feedback from clients and other stakeholders;
- considering how to manage the possible transition to another provider; and
- considering new approaches at the completion of the current implementation period of the contract.

Developing a succession plan will help organisations focus on such issues as the timing of a review of the arrangements and how the activity is to be reviewed. The review should look at the activities being performed and whether they are achieving the desired outcomes. A review should also examine cost-effectiveness and efficiency issues.

Succession planning should continue throughout the life of the contract to ensure the organisation:

- maintains knowledge of the situation and can be an intelligent and informed purchaser;
- can deal with changes in the market;
- can accommodate changes in government policy or other needs; and
- allows for changes in community expectations.

Succession planning also involves an analysis of issues that could arise when the contract is due for re-tendering and the strategies needed to be put in place to deal with those issues. Considerations include:

- whether there are alternative means to perform the activity;
- how to encourage fair and open competition to ensure that all tenderers have a reasonable chance of success;
- how to ensure that the organisation retains the knowledge and capacity to respecify requirements and manage contracts;
- how to explain the flexibility to respond to changes in policy direction;
- ownership and transfer of assets; and
- what the organisation has learned from the previous process that would help to improve the re-tendering process.
Style and types of relationships

Application of the most appropriate contractual relationship can deliver significant performance improvement and savings in the baseline cost. Organisations in the private and public sector have demonstrated the benefits of taking a fresh look at contractual relationships to achieve the most efficient and effective method of service delivery. Examples of improvements include:

- 20% productivity increase and 9% cost decrease\(^\text{15}\); and
- up to 30% decrease in costs over 3–5 years in partnering type arrangements.\(^\text{16}\)

The succession plan provides an excellent opportunity to revisit the type of relationship adopted for the contracting of goods and services.

As previously mentioned in Part 2 of this Guide, there are two styles of relationship and four relationship types:

![Figure 11—The contract relationship continuum](image-url)

Each of these is discussed in detail on the following pages.

\(^{15}\) 1997 figures—Institute of Outsourcing (http://www.outsourcing.com)

\(^{16}\) Trusting the team—The Best Practice Guide to Partnering in Construction—Centre for Strategic Studies in Construction, The University of Reading, 1995
Traditional relationships

Historically, relationships between purchasers and providers have been dominated by legal and contractual obligations. The legal framework creates a strong compliance/control relationship relying on extensive checking and verifying of the contract against the service delivery and a tendency towards an ‘adversarial’ culture. This relationship centres on the obligations set out in the contract and management of the relationship tends to be ad hoc and at arm’s length, with each party seeking maximum advantage. There are circumstances, however, where this type of relationship may be appropriate.

A traditional relationship is most beneficial where the scope of the service is narrow and accurately defined; potential for variations during the contract period is low; and the risk of failure of the service is also low. These types of services generally are not critical to the delivery of core outcomes. Examples of the types of services where advantages of the traditional relationship can be gained are:

• cleaning;
• catering; and
• grass cutting.

Such services can be managed with a traditional relationship requiring a minimum consumption of resources to manage the contract due to the low level of contact that is required with the provider.

However, the traditional approach to relationships can be hampered by problems such as:

• poor communication;
• lack of continuity between projects;
• variations in the quality of services;
• time-consuming administration in processing variations, claims and negotiations; and
• a tendency towards an adversarial relationship.
Cooperative relationships

Cooperative relationships bring the contracting parties closer together and involve both the purchaser and provider, to varying degrees, in cooperative management of the contract. This approach incorporates ideals such as developing trust, obtaining commitment and improving communication (some of the key elements of partnering as discussed next), but does not extend to some of the higher ideals, eg, the sharing of risk.

Some organisations are not ready to move away from the traditional control approach to contract management. This may be a positive decision based on the assessment of risks (or risk-aversion) or a passive consequence of the organisation’s culture and/or a lack of, contract management skills and related experience.

The cooperative style of relationship can be used as a stepping stone (as a method of trialing new approaches to contract relationships) to ascertain whether there is potential to develop the relationship, at an acceptable level of risk.

Cooperative relationships can expose the organisation to an increased level of risk that needs to be managed. There can also be a decrease in the level of control as some of the responsibility for management is transferred to the provider. This can have accountability implications which need to be managed.

If the organisation transfers aspects of management control to the provider without properly assessing the risks and implementing appropriate controls, it may be exposed to inappropriate levels of risk. In addition, transferring one aspect of management control and replacing it with another, may be inefficient and actually increase costs. The approach to sharing risk responsibilities and managing risk should be considered on the basis of achieving efficiencies. In simple terms, any change should be based on an assessment of what risks each party is best able to manage.

Examples of the types of services where advantages of the cooperative relationship can be gained are:

- facilities management;
- internal audit; and
- provision of temporary administrative staff.

The cooperative approach to relationships can be hampered by problems such as:

- the level of risk increases more than the perceived benefits of transferring risk to the provider; and
- the organisational culture is not able to move away from the traditional relationship framework.
The purchaser needs to ensure that there is not an attempt to naively transfer risk to the provider particularly where, in the Commonwealth’s case, the ultimate responsibility is seen to be with the government.

**Partnering relationships**

Partnering is a formalised process underpinned by both a legal contract and moral commitment by key stakeholders and other parties to act in the best interests of each other. The basis of partnering is: *together we can solve problems and maximise opportunities.*

Partnering in contract relationships has existed for over 10 years in the construction industry in Australia\(^1\) and, in this context, is a developing means by which purchasers and providers can work more effectively together to provide a different approach to managing contractual and other operational arrangements.

Partnering relies on commitment by parties beyond the terms of the contract. It also involves parties outside the contract (key clients and stakeholders can also be involved in relevant aspects of overall contract management).

Principles of partnering can be applied at an operational level with contracts that deliver support services to core business areas. While the contract may be between the whole organisation and provider, a service area removed from the business area will often manage it, e.g., a Contract Management section. In this sense, the service area is a client of the business area and can be involved in the contract management, as appropriate, to ensure their needs are met.

Partnering can promote contract effectiveness and efficiencies through:

- commitment by both parties based on common objectives;
- equity and trust, e.g., purchaser and provider interests are considered (*win/win* thinking);
- implementation of joint strategies for developing mutual goals; and
- continuous and joint evaluation.

As the management style shifts further along the non-traditional end of the relationship continuum, the level of actual control by the organisation diminishes while the organisation’s accountability for the service being provided remains the same. As discussed in cooperative relationships, the risks associated with this approach need to be properly assessed to ensure only appropriate aspects of traditional contract management processes are affected. Whatever processes are put in place must ensure the accountability obligations are met.

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\(^1\) Partnering—A Strategy for Excellence, Master Builders Australia, 1992
Another feature of partnering which inherently increases the risk in contract management is the involvement of parties outside the contract. These risks need to be identified and assessed. Common treatments for these risks are:

- development of a memorandum of understanding between the contracting parties and clients/stakeholders explaining respective roles and responsibilities; and
- strict communication protocols to avoid information being misinterpreted or misapplied.

Examples of the types of services where advantages of the partnering relationship can be gained are:

- security;
- printing services; and
- web page design and delivery.

**Alliance relationships**

Alliance relationships describe the situation where the purchaser and provider assume a degree of joint management responsibility for the delivery of the required goods or services. It takes the key elements of partnering to the next step by having a risk/reward sharing philosophy as well as a transparent or open-book approach towards all financial matters, including cost and profit.

Alliance relationships are best suited for providing services that are difficult to define or are likely to change substantially over time, critical to an organisation’s performance or requiring innovative solutions from the provider and creative management by the purchaser. They are also useful where the industry from which the goods or services come from has only limited experience such that providers are not able to adequately predict and price the goods or services. They are also beneficial for long-term, strategic contracts as each party relies absolutely on the performance of the other.

Alliance relationships are the pinnacle of cooperation. They demonstrate a shared vision by the contracting parties and an understanding of each other’s operations, including mutual reliance and a determination to achieve the best for each other and related stakeholders.
Some of the key elements of alliance relationships include:

- a no-blame, no disputes concept;
- open-book or transparent accountability, including detailed performance or outcome terms with incentive based remuneration linked preferably to measurable KPIs;
- team development, based on best for job allocation of resources and the efficient use of expertise;
- co-located project premises for both purchaser and provider to facilitate the sharing of information, knowledge and skills;
- communication and quality training;
- trust and alignment of objectives across all participants;
- use of SLAs with regular reviews of strategic directions and performance outcomes;
- the identification and allocation of risks. Risks are identified and responsibility for them clearly allocated; and
- risk/reward philosophy with a willingness, as appropriate, to share losses and profits and regular re-assessment of continuation of the arrangement which is linked to the achievement of KPIs.

The obvious risk to address and manage in alliance relationships is that the parties get too close. This is a natural convergence but presents risk for all concerned if it is not managed. Some issues to address are:

- the need to retain independence and be perceived to be independent;
- managing performance so it is not construed as collusive or monopolistic; and
- ensuring the contract manager accesses sufficient information both from internal and market sources to enable a realistic assessment of the provider’s performance.

A further possible risk of alliance relationships is where the purchaser and provider do not have cultures which are compatible.

Alliance relationships are best suited for:

- program delivery;
- contracts for the supply of specialised equipment or sensitive material;
- strategic and policy advice; and
- large, complex projects with significant scope for innovation.

Alliance relationships should never get so close that it becomes impossible for either party to get out of the arrangement.
Better Practice Example 12

Construction of the National Museum of Australia and Australian Institute of Aboriginal and Torres Strait Islander Studies—Auditor General Audit Report No. 34, 1999–2000

The ANAO undertook an audit of the construction of the National Museum and Australian Institute of Aboriginal and Torres Strait Islander Studies. As the project’s risk/reward outcome was tied to the collective performance of the Alliance partners, ‘no blame, no dispute’ clauses ensured that each partner maintained an interest in maximising the performance of the other partners rather than simply serving their own best interest. The audit found that the Alliance partners and their insurers agreed to waive their rights to pursue legal action against one another for any project-related event except ‘wilful default’.*

Given the complexity of the project, and the number of sub-contracts to be managed, a Quality Working Group and an Independent Quality Panel were formed to establish and measure performance against quality standards. This approach may not be necessary where alliance concepts are being incorporated into the management of a single contract, however, in more complex scenarios the use of independent quality assurers may be worth consideration.

* The Alliance agreement defined ‘Wilful Default’ as ‘such wanton and reckless act or omission as amounts to a wilful and utter disregard for the harmful and unavoidable consequences thereof…but shall not otherwise include any error of judgement, mistake, act or omission, whether negligent or not, made in good faith…’

Constraints in relationship application

In seeking a successful relationship there are a number of factors that may prevent reaching a particular relationship style. Appendix 4 provides a summary of possible constraints with suggested remedies to resolve those constraints.

Pricing structures

Having determined the most appropriate relationship with which to manage the contract, the pricing structure adopted must reflect the nature of risk inherent in that relationship and also the risk associated with the contract’s affect on service delivery.

A number of pricing structures exist with regard to the management of contracts and are summarised in Table 17.
The provider guarantees to perform the work or services as specified in the contract documents for a fixed price no matter what the actual cost is.  
Note: If a significant level of variation occurs (more than 10-20% of the contract cost), and detailed explanation and/or reporting is required, then the use of a lump sum contract was not the appropriate choice for this service and the contract structure should be revisited.

The provider agrees to perform an estimated quantity of work for an agreed unit price. This agreed unit price is multiplied by the actual quantities delivered to determine the final cost. This is essentially a series of little lump sum payments per quantity delivered.

The purchaser reimburses the provider in two parts:  
• a fixed lump sum, usually paid monthly, covering all non-direct labour costs including profit, overheads, management, supervision, facilities and telecommunications; and  
• work carried out under the contract is reimbursed at the net cost to the provider for resources such as labour, materials and equipment.  
Their may be a perception that as the fixed lump sum (and hence profit) does not depend on the quantity of work done, there will be less incentive to expend more hours. In fact the reverse applies, eg, if the provider can minimise its use of labour, it will expend less of the fixed management fee on supervision to maximise the profit component of its management fee.

The purchaser reimburses the provider for the cost of the resources incurred in providing the services plus an agreed percentage or amount to cover the provider’s overheads. The profit component is either an agreed percentage or fixed amount, or is determined by the performance of the provider.

<table>
<thead>
<tr>
<th>Pricing structure</th>
<th>Description</th>
</tr>
</thead>
</table>
| **Lump sum**      | The provider guarantees to perform the work or services as specified in the contract documents for a fixed price no matter what the actual cost is.  
Note: If a significant level of variation occurs (more than 10-20% of the contract cost), and detailed explanation and/or reporting is required, then the use of a lump sum contract was not the appropriate choice for this service and the contract structure should be revisited. |
| **Unit rate**     | The provider agrees to perform an estimated quantity of work for an agreed unit price. This agreed unit price is multiplied by the actual quantities delivered to determine the final cost. This is essentially a series of little lump sum payments per quantity delivered. |
| **Management fee**| The purchaser reimburses the provider in two parts:  
• a fixed lump sum, usually paid monthly, covering all non-direct labour costs including profit, overheads, management, supervision, facilities and telecommunications; and  
• work carried out under the contract is reimbursed at the net cost to the provider for resources such as labour, materials and equipment.  
Their may be a perception that as the fixed lump sum (and hence profit) does not depend on the quantity of work done, there will be less incentive to expend more hours. In fact the reverse applies, eg, if the provider can minimise its use of labour, it will expend less of the fixed management fee on supervision to maximise the profit component of its management fee. |
| **Cost plus**     | The purchaser reimburses the provider for the cost of the resources incurred in providing the services plus an agreed percentage or amount to cover the provider’s overheads. The profit component is either an agreed percentage or fixed amount, or is determined by the performance of the provider. |
Deciding on the most appropriate pricing structure

There are no set rules to determine which pricing structure is the most appropriate. However, there are pricing structures that are more conducive to the success of particular relationship types.

Generally, if a contract is best supported by a non-traditional relationship, the organisation should consider moving away from the standard lump sum payment schedule. As with the continuum on which the relationship styles exist, pricing structures share a similar continuum moving from traditional ‘lump sum’ arrangements through to more flexible ‘cost plus’ structures.

The choice of cost structure can either increase or decrease the risk associated with the provision of contracted services and, in turn, business efficiencies. Getting the best fit between relationship and cost structure is therefore very important to ensuring the contract’s effectiveness.

For basic or easily defined services, where the item or requirement can be 100% defined and the purchaser is confident that the requirement will not change, a contract with a traditional relationship and fixed pricing structure will be the most appropriate choice. Once that certainty is lost, the choices expand and become more complex. For services closer to core business (e.g., program delivery, policy, research and development) where the scope is difficult to define clearly, technology is changing and continuous improvement is essential, a non-traditional relationship with a flexible pricing structure such as a management fee, is likely to be more suitable.

Table 18 compares some of the characteristics of different types of relationships and pricing structures. The relationship characteristics may change (many probably will) over the duration of the relationship and each contract should be reviewed prior to its end (or any extension or continuance).
Table 18—Getting the right pricing structure

<table>
<thead>
<tr>
<th>Element</th>
<th>Service type</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Non Core</td>
</tr>
<tr>
<td>Relationship Type</td>
<td>Traditional</td>
</tr>
<tr>
<td>Scope of Service</td>
<td>Fixed</td>
</tr>
<tr>
<td>Contract Term</td>
<td>Short</td>
</tr>
<tr>
<td>Pricing structure</td>
<td>Lump sum</td>
</tr>
<tr>
<td>Performance</td>
<td>Easy to measure</td>
</tr>
<tr>
<td>Objective</td>
<td>Reduce costs</td>
</tr>
</tbody>
</table>

The basic decision on which type of arrangement is best suited will depend to a large extent upon the level of information and specification that is available to the organisation. However, it should be noted that the method of pricing specified at the contract stage imposes certain characteristics that cannot be changed irrespective of the actual relationships that may, or may not, develop between the provider and the purchaser.
Succession plan

The succession phase at the end of the contract is often overlooked at the time the contract is awarded. If there is no provision made in the contract, then the succession phase should be negotiated with the provider well in advance of completion of the contract term. If succession is covered in the contract then it should be reviewed and updated as necessary, before the actual end of delivery.

It is important not to underestimate the planning and management effort required to ensure that there is a smooth transition from one contract to another. The uninterrupted delivery of goods and services is key to continued delivery of organisational outputs or business continuity, one of the risks the organisation must manage at this stage (particularly if there is a change of provider).

An essential process in the succession phase is a final evaluation and feedback on the contract, provider and review of the performance of the contract. It is important lessons learned be identified and applied to further contract negotiations and contracts. A review should include an evaluation of the following:

- Relationships—if partnering or other non-traditional relationship, did it work?
- The contract—identification of any changes in service levels, evaluation of the relevance of current contract requirements, including whether contract provisions should be updated to reflect technology changes such as the growth in the use of EFT.
- Procedures—did processes work?
- Performance—were performance indicators and incentives relevant, well used, easy to measure and ultimately useful?
- Costs—review/audit of costs to ensure adequate documentation and payments in accordance with the contract.
- Customer satisfaction—were customers satisfied with the service?

As with the transition phase, to ensure effective management of this process a succession plan should be prepared in sufficient detail to outline all tasks to be completed and allocate clear responsibility for completing them. Specific issues that are relevant at the completion of delivery are summarised in Table 19.
### Table 19—Contents of a succession plan

<table>
<thead>
<tr>
<th>Succession issue</th>
<th>Approach</th>
</tr>
</thead>
<tbody>
<tr>
<td>Time line</td>
<td>A realistic time line should be prepared and agreed with the provider</td>
</tr>
<tr>
<td>Written procedures</td>
<td>May need to be updated or prepared to ensure a smooth hand over</td>
</tr>
<tr>
<td>Demobilisation</td>
<td>Winding down of the existing service provider and setting a time for them to leave your facilities</td>
</tr>
<tr>
<td>Strategy and targets</td>
<td>Although service contracts do not generally have practical completion clauses, the final payment and the release of any securities needs to be established. In service contracts ‘completion’ should include the continuity of service until handover (eg, handing over of all assets, documentation, cooperating with the new provider) with clear target dates set for each activity. As there is likely to be a number of issues to be resolved, a manager from the purchaser and the provider should be nominated and be responsible for the coordination of the succession</td>
</tr>
<tr>
<td>Information control (ownership)</td>
<td>To enable the purchaser to retain control of the services it is important that relevant information, in a suitable format, belongs to the purchaser at the end of the contract</td>
</tr>
<tr>
<td>Confidentiality</td>
<td>The purchaser should ensure confidentiality of information, this is normally covered by the contract</td>
</tr>
<tr>
<td>Copyright / intellectual property</td>
<td>The purchaser should ensure that copyright is retained and that any software systems that have been developed by the provider can continue to be used by the purchaser</td>
</tr>
<tr>
<td>Data retention/ migration of data</td>
<td>The purchaser should ensure that all contract material, eg, documentation, reports, guides, intellectual and real property information is updated and returned at the end of the contract. The format should be clearly defined (for example electronic or hard copy, how many). This should be covered by the contract or SLA</td>
</tr>
<tr>
<td>Training</td>
<td>In a new arrangement there could be some revised roles and responsibilities and this may require some additional training</td>
</tr>
</tbody>
</table>

*continued next page*
<table>
<thead>
<tr>
<th>Succession issue</th>
<th>Approach</th>
</tr>
</thead>
<tbody>
<tr>
<td>Resource transfers</td>
<td>If there is a new provider or if the services are being returned in-house then there could be transfers, redeployment and possible redundancies. Although this will be the responsibility of the provider, the purchaser needs to ensure that the appropriate human resource policies and procedures are in place to minimise the effect on organisational culture.</td>
</tr>
<tr>
<td>Resources</td>
<td>The provider may demobilise resources too early or may have difficulties in retaining personnel once the provision of services has been given to a new provider. The purchaser should be able to bring personnel in to ensure continuity of services. It could be that the hand over to the new provider is phased to overcome this problem and the final payment is linked to the satisfactory continuity of services. A system of milestone payments could be linked to key activities and target dates.</td>
</tr>
<tr>
<td>Debriefing</td>
<td>If there is a change in provider then two levels of debriefing may be required: • unsuccessful tenderers; and • existing provider. If there has been a long relationship with the existing provider then a more detailed level of debriefing may be required.</td>
</tr>
</tbody>
</table>

The succession phase is the organisation’s best opportunity to review how the contract has performed, and to assess how relationships and pricing structures may be better managed to achieve more cost effective outputs. Only when the most appropriate mix of relationship and pricing structure has been identified can further improvements be realised by adopting the performance management techniques outlined in this Guide.
Appendix 1

Glossary

The following table summarises a number of key terms and concepts and their meanings for ease of reference.

<table>
<thead>
<tr>
<th>Principle</th>
<th>Explanation</th>
<th>Examples</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Contract</strong></td>
<td>• establishes a purchaser/provider relationship</td>
<td>The same meaning as in law: A contract between two or more parties in which there is offer of a service (by the provider); acceptance of that offer (by the purchaser), and consideration (usually payment for the service delivery)</td>
<td>A contract term may be specified dates (from 12 January 2000–23 March 2003) or based on actions (from delivery of the first shipment of goods until the order is finalised)</td>
</tr>
<tr>
<td><strong>Contract term</strong></td>
<td>• the time the parties have agreed to be in the relationship</td>
<td>The time between the commencement of a contract and its termination</td>
<td></td>
</tr>
<tr>
<td><strong>Transition</strong></td>
<td>• transition phase</td>
<td>Phases during the contract term (usually at the commencement and termination) during which management structures are developed to implement change</td>
<td>The transition phase allows initial development of the contract relationship and protocol. The succession phase provides for realigning process when the contract is renewed or relet</td>
</tr>
<tr>
<td></td>
<td>• succession</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
### Contract Management

<table>
<thead>
<tr>
<th>Principle</th>
<th>Explanation</th>
<th>Examples Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Contract management</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• on-going contract management</td>
<td>The activities undertaken in relation to the on-going (day-to-day) management and contract succession</td>
<td>Contract starts as early as the selection of a successful tenderer. The contract management team should be involved in the contract negotiation and should develop the transition plan and contract management plans (including succession strategies)</td>
</tr>
<tr>
<td>• contract succession</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Contract performance</strong></td>
<td></td>
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</tr>
</tbody>
</table>
| • service delivery | Contract performance has two dimensions:  
  • service delivery standards (usually time, cost, quality and quantity)  
  • the standards of administration by the purchaser |  |
| • contract management |  |  |
|  |  |  |
| **Succession** |  |  |
| • what happens at the termination of the contract | Succession strategies and plans are necessary to determine what arrangements are needed at the end of the contract term | Contract succession considerations include whether to seek new tenders, roll the existing arrangements forward or bring the activity in-house |
Appendix 2

Specific transition issues

These are issues that need to be addressed during the transition phase because they need to be settled prior to the contract’s commencement or because they represent risks to a successful implementation of the contract.

Planning the hand-over to an external provider will involve extensive internal communication and discussion. It is important to establish a positive environment for the change and thereby enhance the chance of success. Specific issues that are often overlooked during transition phase include:

- a mechanism for the management of morale (in-house to existing provider) and for maintaining service delivery standards;
- establish communication strategy—include all staff not just those directly affected
  
  # communicate with:
  ~ management
  ~ workforce affected
  ~ customers/clients
  ~ workforce interested but not affected
  ~ legal department/adviser
  ~ purchasing department
  ~ existing provider
  ~ successful provider
  ~ unsuccessful tenderers
  ~ unions
  ~ public

- for in-house staff, assist with outplacement counselling, training and redeployment processes;
- for existing provider, undertake extended debriefing; and
- targets should be set for the completion of, for example, the following:
  # safety procedures for all operations
  # standard work lists
  # verification of the asset register
  # environmental audits if required
  # establishment of environmental procedures
  # implementation of a quality system
  # human resource requirements or concerns
  # security issues.
# Appendix 3

## Checklist for the appointment of providers

<table>
<thead>
<tr>
<th>Task</th>
<th>Yes/No</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Contract Management</strong></td>
<td></td>
</tr>
<tr>
<td>1. Does the tender statement of requirements/procedural manual/SLA specify:</td>
<td></td>
</tr>
<tr>
<td>• objectives</td>
<td></td>
</tr>
<tr>
<td>• milestones and timetables</td>
<td></td>
</tr>
<tr>
<td>• reporting requirements</td>
<td></td>
</tr>
<tr>
<td>• proposed fees and charges</td>
<td></td>
</tr>
<tr>
<td>• proposed payment arrangements</td>
<td></td>
</tr>
<tr>
<td>• content, timing and format of reports</td>
<td></td>
</tr>
<tr>
<td>• information to be provided by the provider</td>
<td></td>
</tr>
<tr>
<td>• responsibilities of the purchaser and the provider</td>
<td></td>
</tr>
<tr>
<td>• contact officers and numbers</td>
<td></td>
</tr>
<tr>
<td><strong>Assessment of Performance</strong></td>
<td></td>
</tr>
<tr>
<td>2. Have periodic assessments been made throughout the contract?</td>
<td></td>
</tr>
<tr>
<td>3. Has a report been prepared after each milestone/evaluation period of the contract commenting on the provider’s performance?</td>
<td></td>
</tr>
<tr>
<td>4. Has a report been prepared at the completion of the contract commenting on overall performance?</td>
<td></td>
</tr>
</tbody>
</table>
## Appendix 4

### Relationship constraints and remedies

Constraints are any factors (existing or forecast, internal or external) that may prevent the use of a preferred relationship type. The table below provides some examples of constraining factors and some approaches that may be used to remedy them.

<table>
<thead>
<tr>
<th>Constraint</th>
<th>Possible remedy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Poor management skills – internally or externally</td>
<td>• determine required skills and competencies</td>
</tr>
<tr>
<td></td>
<td>• provide appropriate training</td>
</tr>
<tr>
<td></td>
<td>• recruit skilled contract managers</td>
</tr>
<tr>
<td>Deficiencies in resourcing</td>
<td>• establish resource needs and provide budget</td>
</tr>
<tr>
<td>Inaccurate information with which to define performance levels</td>
<td>• ensure service levels are appropriate</td>
</tr>
<tr>
<td></td>
<td>• involve provider in designing performance measures and obtaining information</td>
</tr>
<tr>
<td>Insufficient information in the marketplace from which to choose a final supplier</td>
<td>• ensure tender is open and advertised to the public</td>
</tr>
<tr>
<td></td>
<td>• promote tender</td>
</tr>
<tr>
<td></td>
<td>• use contract specialists</td>
</tr>
<tr>
<td></td>
<td>• request more information from all tenders</td>
</tr>
<tr>
<td>Insufficient suppliers in the marketplace</td>
<td>• seek alternate solution</td>
</tr>
<tr>
<td></td>
<td>• use all suppliers in panel arrangement</td>
</tr>
<tr>
<td></td>
<td>• seek fixed price contracts</td>
</tr>
<tr>
<td>Inadequate support systems with which to measure performance</td>
<td>• improve support systems</td>
</tr>
<tr>
<td></td>
<td>• measure performance using alternate approaches</td>
</tr>
<tr>
<td>Poorly defined specifications</td>
<td>• use experts in designing specifications</td>
</tr>
<tr>
<td></td>
<td>• involve stakeholders in setting specifications</td>
</tr>
<tr>
<td></td>
<td>• involve industry in setting specifications</td>
</tr>
<tr>
<td></td>
<td>• use benchmarked standards in specifications</td>
</tr>
<tr>
<td>Contract managers are not sufficiently empowered to perform their roles</td>
<td>• adjust management structures and approaches to allow managers sufficient flexibility in their role</td>
</tr>
<tr>
<td></td>
<td>• change reporting structures</td>
</tr>
<tr>
<td></td>
<td>• move to flatter management style</td>
</tr>
</tbody>
</table>