

# **SouthWest One**

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# **Performance**

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# **Management**

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# **and Benefits**

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# **Realisation**

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**Somerset County Council**

**Audit 2009/10**

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# Introduction

**1** Somerset County Council, Taunton Deane Borough Council and Avon and Somerset Police Authority created a joint venture company known as SouthWest One (SWO) with IBM to deliver services under a ten-year contract originally worth £400 million. Its vision was to enable the social transformation of Taunton, Somerset and the South West, to deliver better value for money for taxpayers and improve access to services for residents within Somerset.

**2** The contract is a complex arrangement involving service delivery and financial risks for the bodies involved. These were identified and correctly assessed at the start of the contract. However, the financial success of the contract is dependent on SWO's performance in delivering procurement savings and the ability of the organisation to manage contractual performance.

**3** The original estimated procurement savings over the period of the ten-year contract for Somerset County Council (the Council) and Taunton Deane Borough Council is about £192 million. Overseeing and agreeing the achievement of savings is therefore a crucial factor in the success of the contract. It is essential that changes necessary to realise the identified savings are carried out. This will only be achieved through effective contract management arrangements resulting in cost reductions, increased efficiency or improved delivery of services.

**4** As part of our audit which assessed arrangements for delivering value for money, we have assessed the performance management and benefits realisation arrangements of the SWO contract.

# Audit approach

5 Under the Code of Audit Practice we included time within the 2009/10 audit to:

- follow up our earlier work on the SWO contract;
- examine the evolving arrangements for checking and reporting on contract performance;
- review the arrangements for checking, quantifying and verifying the expected savings (benefits realisation) including a review of progress; and
- inform our annual assessment of the arrangements for securing value for money.

6 This review built on our earlier work and informed by:

- the Council's own reviews of the contract;
- the updated review of the performance management arrangements for SWO undertaken in June/July 2010 by internal audit; and
- our assessment of certain SWO performance indicators dovetailed with the internal audit review.

# Main conclusions

**7** The first three years of the contract have been a difficult time for both the Council and SWO, largely owing to the challenge of implementing SAP across the County Council and its partners. Both SWO and the Council have clearly spent significant time and money to make a success of the arrangement but so far the benefits have not fully met those originally envisaged.

**8** Performance management arrangements of the contract have improved over the last year but more work is required. The Council has addressed data quality issues identified in 2009. Performance indicator definitions were re-assessed and an independent evaluation of the performance management arrangements undertaken. Monthly service performance reports are produced by SWO, however, more work is required to ensure the accuracy of the indicators. Some indicators are still to be agreed. Without them, key areas of the contract cannot be monitored. The Council should review key performance indicators (KPIs) ensuring that they are meaningful and provide an appropriate measure of performance.

**9** Overall contract management arrangements are robust. Interdepartmental working groups meet weekly and aid the Client Services Team with the day-to-day management of the contract. Liaison with SWO has improved and parts of the contract re-negotiated to the benefit of the Council. However, SAP deficiencies have affected the ability to report on the arrangement. Problems obtaining accurate or complete information to support category management and significant system difficulties were overcome to produce the Council's 2009/10 accounts.

**10** Financial reporting of the contract needs simplification. The use of differing price bases for costs and savings inhibits effective assessment of the contract. Savings can be less in real terms than forecast in 2007/08. The ability to drive out savings is likely to be significantly reduced because of the current economic climate and limits on available financial resources.

**11** Potential savings of £45.5 million (£22 million implemented and £23.5 million awaiting implementation) have been identified and agreed. The Council is in the process of delivering these savings, with a further £40 million identified by SWO but not yet agreed by the Council for delivery (the 'pipeline'). However, actual savings are below those originally forecast and currently stand at £3.3 million 'cashed', part of the £22 million of benefits implemented – savings to this value will flow as spend is incurred in future years. To realise the original savings profile will require a significant increase in the delivery of savings but this may be curtailed given the reductions in local government spend nationally. Managing the 'gain share' arrangement within the procurement project needs to be used to further incentivise the identification and delivery of savings.

**12** In the current financial climate the Council has rightly questioned whether it could buy services at a reduced cost. Public sector contracts are being re-assessed across the country and many including those of the Council are being re-negotiated. It is also questioning whether some savings identified internally by the Council should be included within the procurement savings claimed by SWO. This is relevant as the claimed procurement figures approach the £75 million 'gain share' level. The Council has taken steps through the formal contractual processes to clarify this point.

**13** IBM has provided much needed marketing skills and experience to aid economic development in Somerset. Their involvement in the Inward Investment Agency (Into Somerset) and the Somerset University Partnership Project have been appreciated. Similarly, access to specialist skills and experience has proved beneficial.

**14** The financial benefits achieved through the SWO unitary charge continue to benefit the Council. These include a discounted price for the delivery of SWO services, continued uplift of the KPIs over the contract years, and the absorption by SWO of any price and volume increases related to the contracts novated to SWO by the Council. The move to a partially variable Unitary Charge has benefited the Council by reducing the initially contracted spend, across the term of the agreement.

# Detailed findings

## Introduction

**15** The contract with SWO is a complex arrangement involving:

- providing improved support services such as finance and human resources;
- a major project to transform procurement arrangements across the three bodies; and
- other transformation projects that were initially to be funded from procurement savings.

**16** At the start of the contract five 'core' transformation projects were agreed:

- implement the SAP enterprise resource management system;
- replace the former customer relations management system and improve customer access;
- roll-out of the People Excellence Model throughout SWO;
- a locality based service delivery pilot based on Wellington; and
- the procurement transformation project.

**17** The total value of the contract over ten years was £400 million (at 2007/08 prices), with the in-scope services costing some £328 million of this total. These costs are subject to inflation based on three principle indices: the government pay award, the consumer price index and the annual survey of hours and earnings. Transformation services excluding any 'gain share' payments have cost around £58 million, but include the requirement to identify around £192 million of cashable procurement savings achievable without impacting on service provision.

**18** Because of significant limits in local government funding, the original targets need to be revisited to reflect the reduced savings that can now be derived. Savings are not guaranteed by SWO but they have given an undertaking to remain on-site until achieved.

**19** Incentives were given to SWO to achieve savings through a 'gain share' arrangement. Thirty per cent of additional savings are payable to SWO when they reach £75 million, paid across the agreed profile when the saving is met. By September 2010 the total identified and agreed savings for the transformational projects amounted to £45.5 million. Benefits scheduled since the contract commenced at October 2010 were £5.2 million of which £3.3 million (63 per cent) has been delivered.



**20** IBM has provided other benefits. A recent example would be enhancing the Council's wide area network internet provision to about 400 locations. SWO at no extra cost to the Council has delivered a network based on fibre optic technology, improving speed and capacity at Council locations including all schools. Direct and indirect support has also been given to the Somerset economy. Advice has been given to the Somerset Strategic Partnership and the Inward Investment Agency 'Into Somerset', and offices opened in Taunton and a service centre in Highbridge.

**21** The business case for the initiative was based on an overall affordability budget. All proposals had to be met within the 2007/08 budget. The basic principles were the:

- budgets of the back office services set the threshold of the affordability envelope for those services;
- payment to the SWO would be by a unitary charge, which is capped but may decrease through prescribed mechanisms or business growth; and
- arrangement would be viable if the unitary charge was less than the affordability envelop.

**22** Major changes have occurred since signing the contract in September 2007. However, the need to manage an increasing demand for services within a constrained budget remains. Changes in service delivery were anticipated within the contract and negotiations have taken place to vary costs and delivery of some services. The expected procurement savings are now crucial to support services rather than to finance major transformation projects.

**23** The following sections outline our findings on performance arrangements and achievement of benefits.

## **Performance management arrangements**

**24** Performance management arrangements have improved over the last year but more work is required to maintain the KPI suite.

**25** SWO performance management arrangements were reviewed by internal audit in September 2009. This supported the Audit Commission's data quality review forming part of the annual value for money conclusion. Five key performance indicators were selected for the 2008/09 review and included an assessment of:

- the management arrangements in place to ensure the relevance; accuracy, timeliness and completeness of the data; and
- the accuracy of the indicator itself.

**26** Only one out of the five indicators passed the required standards:

- there was inadequate client control over the definitions used to describe the performance indicators;
- it was not clear what each performance indicator was measuring and whether it added value;
- there was no independent review of the source data used; and
- there was no assurance the reported result was reliable.

**27** Assurance for the 2009/10 value for money conclusion was gained by revisiting the recommendations during July 2010 and a set of performance measures assessed by both internal and external audit.

**28** Definitions were re-assessed with SWO and an independent evaluation made by the Performance Management Officer. No errors calculating the selected performance indicators were found and the management arrangements used for their collection were robust. Although a definitive list of KPI definitions is not available the majority are agreed. The Council is closing discussions over agreeing KPIs and a final set will be circulated shortly.

**29** Reporting against the KPIs is the responsibility of SWO and targeted spot checks by the Council's client team ensure the indicators are working in the way intended. The Council challenges the information produced by SWO, resulting in SWO amending reports and KPI penalties applied.

**30** Some performance indicators are based on input rather than outcome measures. Others provide limited benefit only confirming what has been in place since the start of the contract, for example bankings are made daily. The Council should review KPIs to ensure they are meaningful and provide an appropriate measure of performance.

## Recommendations

**R1** Performance measures are a joint responsibility and should continue to be improved to ensure they are meaningful, relevant, and challenging to drive improvement in the delivery of services.

**R2** Extra spot checks on reported performance would provide further validation of the management information produced by SWO.

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**31** Effective governance arrangements were implemented at the start of the contract to oversee and report on the delivery of services. Our original assessment of the contract reviewed these and found them to be robust and working effectively. The arrangements to oversee benefits are shown in Figure 1.

Figure 1: **Governance arrangements**

## Summary of Responsibilities

### Senior Management and Boards

- Approve benefits register
- Review benefit reports
- Agree and assign actions
- Instruct benefit owners

### Benefit Owners (BO)

- Ensures benefit is realised
- Lowest in hierarchy with most to gain from benefit, and authority for related decision making

### Data Representatives

- Measurement of baseline
- Ongoing measurement of metrics
- Feeds results to BOs and TBM Team / PMO

### Programme Management Office (PMO)

- Ongoing co-ordination of tracking and reporting process
- Prepares and disseminates benefits reports to relevant boards
- Manages the feedback of actions and updates between Boards and BOs
- Works with TBM team to enhance tracking and reporting processes

### Transformation Benefits Management Team

- Joint team from all four organisations
- Put in place the tracking and reporting system
- Instil benefit realisation culture
- Support analyses and reporting with interpretive commentary
- Publicise achievements in benefit realisation

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Source: SCC 2009

**32** Overall arrangements are robust. However, until recently, weaknesses in the operation of the SAP system deficiencies have affected the ability to report on all aspects of the arrangement. Problems experienced include those associated with SAP Financials and the delay in setting up an effective system to check savings. Officers experienced difficulties getting accurate or complete information to support category management. Although the information was the best available at the time, confidence in its accuracy varied across directorates. Now that these problems have been largely overcome, officers are revisiting the information and the assumptions on which they were made. Some of the original estimates of savings have fallen short of expectations.

**33** One of the key and early benefits of the contract was the ability of SAP to collect and disaggregate information. This is central to the improvement in financial management and corporate governance, and the ability to oversee and manage the organisation. Such benefits have yet to be fully realised, as awareness of and ability to use the system is still developing.

**34** Management of the contract continues to improve. Interdepartmental working groups are meeting weekly to help the Client Services Team with the day-to-day management of the contract. Liaison with SWO has also improved and aspects of the contract re-negotiated, for example the move from a fixed to variable pricing of some of the human resources, property, and design and print aspects of the core services.

**35** Performance management of the main service delivery elements is also improving and only a few penalty payments deducted for below standard services.

**36** Cultural differences continue to require management attention. The original design for a partnership approach started well but the lack of IBM's local government experience in some areas affected the relationship. Work is continuing to improve the situation. The input of the Client Services team and the employment by SWO of skilled and experienced category managers and a Chief Procurement Officer has improved the relationship.

## Benefits realisation

**37** The first three years of the contract have been a difficult time largely owing to the challenge of implementing SAP across the Council and its partners. Both SWO and the Council have clearly spent significant time and money to make a success of the arrangement but so far the benefits have not fully met those originally envisaged.

**38** It was always expected the arrangement would have to adapt to changing circumstances. But the scope and change over the last 18 months has been greater than expected. The fact the Council had already identified the need for change has been to its advantage. The requirement to identify and realise savings has always been seen as essential to the long-term protection of services. Savings were originally intended to fund investments, however, they are now crucial to fund the services themselves.

**39** The objectives to be achieved from the arrangement were set down in the original business case in September 2007:

- improve access to and delivery of customer facing services;
- modernise, reduce the cost of and improve corporate, transactional and support services;
- modernise and transform working methods;
- invest in new world class technologies to improve productivity;
- create an excellent working environment and a more sustainable employment future for staff; and
- create economic development by attracting a partner willing to invest in Somerset.

## Financial savings

**40** Financial reporting of the contract should be simplified. One of the most reported problems has been the ability to understand the changing financial implications of the contract. Our own assessment was complicated by differing price bases in various reports used by the Council. In some the 2007/08 price base has been used, in others, such as the reporting of the procurement savings they are based on current prices. This may mean the actual savings are less in real terms than those forecast in 2007/08 and the shrinking base from which to make savings is having a material effect on success against the original savings profile. The Council should introduce a consistent approach to assessing the impact of inflation on reported savings figures.

**41** Procurement savings are lower than estimated and being achieved later than expected. As available finances are reducing, meeting the original affordability budget will now require a significant increase in the delivery of savings. As stated earlier in the report, to give an incentive to SWO to achieve these objectives a 'gain share' of 30 per cent of savings above £75 million was included in the contract. This is payable as the savings are released across an agreed profile, and not up-front when the savings are identified.

## Recommendations

- R3** The expected savings the procurement project can produce needs to be urgently revised to accommodate the significant changes in local government finances.
  - R4** The Council should introduce a consistent approach to assessing the impact of inflation on reported savings figures.
  - R5** As part of the recommended wider reassessment of expected savings, the 'gain share' arrangement where SWO receives a percentage of identified savings should be continually reviewed.
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**42** Parts of the core service contract were re-negotiated to reflect a variable price rather than the original fixed price contract. Payments now more accurately reflect the service required. Initially parts of human resources, design and print, and property services have been re-negotiated but others are expected in the next round of discussions.

**43** However, the ability to reduce costs is limited by the minimum contractual payment. The employment model which allows staff to be seconded to rather than join SWO limits the flexibility of staff costs. Therefore, if there are significant falls in the need for services the room for manoeuvrability is reduced.

## The way forward

**44** The Council should consider the action plan of recommendations arising from this review. We will continue to monitor progress in addressing these issues as part of the 2010/11 audit.

## Appendix 1 Action Plan

Recommendations	
Recommendation 1	
Performance measures are a joint responsibility and should continue to be improved to ensure they are meaningful, relevant, and challenging to drive improvement in the delivery of services.	
<b>Responsibility</b>	Oliver Woodhams, Group Manager – Business Operations
<b>Priority</b>	High
<b>Date</b>	Ongoing
<b>Comments</b>	<p>Since contract commencement, working together with colleagues from Taunton Deane Borough Council, officers from Somerset County Council's Client Services team have been engaged negotiating a number of improvements to the original price-performance mechanism:</p> <ul style="list-style-type: none"><li>■ Refining the definitions of contractual performance measures (KPIs and SPIs). Over 30 measurement methodologies have been improved.</li><li>■ Ensuring that the 'basket' of measures is relevant. The Council is currently contractualising a framework of over 400 new measurements to drive improvements on the new Wide Area Network infrastructure and developing 12 new indicators to reflect the transformation of the procurement service.</li><li>■ Uplifts to contractual targets to drive service improvements.</li></ul> <p>These negotiations have been challenging commercially. All have involved transferring additional risks to the supplier after the contract has been signed. Furthermore, measuring the complexity and range of the services delivered under the contract in an objective manner is intrinsically difficult.</p> <p>The Council acknowledge further improvements are required and will continue to negotiate changes to performance measures throughout the life of the contract. The next phase will commence with a planned revision to output specifications, however, this will be a long and complex process.</p>

## Recommendation 2

Extra spot checks on reported performance would provide further validation of the management information produced by SWO.

<b>Responsibility</b>	Oliver Woodhams, Group Manager – Business Operations
<b>Priority</b>	Medium
<b>Date</b>	June 2011
<b>Comments</b>	<p>Within the current resources available the Council's Client Team will undertake on a monthly basis a desktop review which seeks to:</p> <ul style="list-style-type: none"><li>■ Evaluate the reported service performance of SWO, including the performance metrics of the KPIs and SPIs;</li><li>■ Identify errors in the monthly performance reports and performance metrics (KPIs and SPIs) that on occasions lead to revised reports;</li><li>■ Identifying misreported metrics and where appropriate pursuing SWO for service credit penalty payments.</li></ul> <p>The Council acknowledges the recommendation and continues to challenge the performance of the SWO contract. However, given the financial climate, magnitude of the contract and resources available, to increase the desktop review to a programme of sample based testing and validation would require additional staff input.</p>

## Recommendation 3

The expected savings the procurement project can produce needs to be urgently revised to accommodate the significant changes in local government finances.

<b>Responsibility</b>	Steve Murphy, Finance Manager Client Services and Ian Conner, Chief Procurement Officer SWO
<b>Priority</b>	High
<b>Date</b>	March 2011
<b>Comments</b>	The Council will ensure the addressable spend is calibrated by changes in local government finance through appropriate targets and expectations.

## Recommendation 4

The Council should introduce a consistent approach to assessing the impact of inflation on reported savings figures.

<b>Responsibility</b>	Steve Murphy, Finance Manager Client Services
<b>Priority</b>	Medium
<b>Date</b>	Ongoing
<b>Comments</b>	

### Recommendation 5

As part of the recommended wider reassessment of expected savings, the 'gain share' arrangement where SWO receives a percentage of identified savings should be continually reviewed.

<b>Responsibility</b>	Matt Jones, Head of Client Services
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<b>Priority</b>	High
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<b>Date</b>	March 2011
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<b>Comments</b>	
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Audit Commission

1st Floor  
Millbank Tower  
Millbank  
London  
SW1P 4HQ

Telephone: 0844 798 3131

Fax: 0844 798 2945

Textphone (minicom): 0844 798 2946