
New South Wales Auditor-General's Report

Performance Audit

Sydney region road maintenance contracts

Roads and Maritime Services



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The roles and responsibilities of the Auditor-General, and hence the Audit Office, are set out in the *Public Finance and Audit Act 1983*.

Our major responsibility is to conduct financial or 'attest' audits of State public sector agencies' financial statements. We also audit the Total State Sector Accounts, a consolidation of all agencies' accounts.

Financial audits are designed to add credibility to financial statements, enhancing their value to end-users. Also, the existence of such audits provides a constant stimulus to agencies to ensure sound financial management.

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We also conduct performance audits. These examine whether an agency is carrying out its activities effectively and doing so economically and efficiently and in compliance with relevant laws. Audits may cover all or parts of an agency's operations, or consider particular issues across a number of agencies.

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In accordance with section 38E of the *Public Finance and Audit Act 1983*, I present a report titled **Sydney region road maintenance contracts: Roads and Maritime Services**.

A handwritten signature in dark ink, appearing to read 'Margaret Crawford'.

Margaret Crawford
Auditor-General
15 June 2017

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Executive summary

Roads and Maritime Services (RMS) is responsible for the Sydney region State roads network. This includes over 2,800 kilometres of roads and associated road corridor infrastructure such as bridges, tunnels and drainage structures. RMS divides the network into three geographical areas: south, west and north zones.

In 1995, RMS first outsourced road corridor infrastructure maintenance for the north zone through a Performance Specified Maintenance Contract (PSMC). The current 10-year PSMC for the north zone will expire in October 2018. Prior to November 2013, RMS maintained roads in the south and west zones through its Road and Fleet Services unit.

In November 2013, RMS outsourced road maintenance services for the south and west zones using Stewardship Maintenance Contracts (SMC). The contracts run for seven years with an option for a further three years at RMS' discretion. RMS estimated that the annual cost of these contracts was around \$240 million in total. In March 2018, the contract prices are due to be reset by negotiation to reflect the contractors' experience with, and better information about, the road networks and routine maintenance requirements.

The SMC model adopted stewardship principles to improve value for money. RMS defined stewardship principles as a broad set of values, attitudes and behaviours, required of the contractor to effectively manage the assets on behalf of RMS. The SMC also includes commercial principles, such as linking risk to reward, and a performance framework where outcomes drive performance.

This audit assessed whether RMS had effectively managed the outsourcing of road maintenance in the Sydney region south and west zones. In making this assessment, we answered the following questions:

1. Did RMS justify the decision to adopt the SMC model?
2. Do SMCs include key performance indicators (KPIs) and incentives which promote efficiency and effectiveness?
3. Does RMS collect high quality information on contractor performance and take action to correct performance deficiencies?
4. Are the expected benefits being achieved?

Conclusion

RMS developed an innovative contracting approach with the SMC. RMS has realised some benefits in the first year, including savings, from outsourcing road maintenance in the Sydney region south and west zones using the SMC. However, RMS' management of the SMC has key elements missing which reduces its effectiveness.

The SMC includes performance measures and incentives to drive efficiency and effectiveness improvements over time.

RMS has established a contract management framework which includes most elements of good practice, including governance and dispute resolution mechanisms. However, it does not have procedures to guide its contract managers in managing specific provisions of the SMC. Consequently, RMS has not exercised several significant SMC requirements, such as having the contractor account for an efficiency dividend in its pricing at the start of each three-year works period. It also has not done enough to assure itself that the contractor provided performance and financial data are correct. This is important because the data is used to measure performance and calculate contractor payments.

RMS assessed that it had achieved around 80 per cent of the expected cost benefit in the initial year of the SMC. However, it has not tracked its achievement of benefits since then.

The Stewardship Maintenance Contract

RMS justified adopting the SMC model and included KPIs to drive efficiency and effectiveness

The SMC model includes features that RMS had not previously used for road maintenance contracts. These included adopting stewardship principles and transferring price risk to the contractor over time as the contractor becomes familiar with the assets being maintained.

The SMC model meets RMS' requirements for flexibility in pricing models, the need for collaboration in asset maintenance planning, promoting innovation and effective performance management.

RMS used many good practices to develop the SMC model, including:

- preparing a robust business case comparing the SMC model to RMS maintaining the road network itself, as well as assessing whether two other contracting models (traditional and alliance) would meet its requirements
- assessing experiences with similar arrangements in other jurisdictions and identifying elements that worked to get the best outcomes
- developing a robust performance framework, which included a mix of efficiency and effectiveness KPIs that reflected NSW Government policy and RMS priorities
- incorporating risk and reward incentives delivered through cost sharing arrangements which change as the contract matures
- using a contract duration that supports RMS priorities and provides an incentive for better quality outcomes.

RMS uses data provided by the contractor to measure performance and calculate payments to the contractor. The SMC includes a specific sanction if RMS finds that the contractor provided incorrect performance data, but no specific sanction if the contractor provides incorrect financial data. If RMS finds that the contractor provided incorrect performance or financial data, RMS can only recover over-payments which may have been made using the incorrect data.

To provide a stronger incentive for the contractor to ensure data it provides is accurate, RMS should consider whether to incorporate stronger sanctions when negotiating the commercial reset due in mid-2018 for south and west zones. RMS should also consider this for the new contract for the north zone when the current PSMC contract expires in October 2018.

RMS' contract management approach and benefits realisation

RMS can improve the effectiveness of its oversight and management of the SMC

RMS does not have SMC specific contract procedures to guide its contract managers. Consequently, RMS has not exercised several significant SMC requirements, such as having the contractors account for an efficiency dividend in their pricing at the start of each three-year works period. Effective contract management should be supported by contract specific procedures, with explanations of, and allocation of responsibility for, the various interventions that RMS may be required to exercise in the SMC.

Performance and financial reporting under the SMC is based on a mix of RMS and contractor provided data. While there are a range of audits of contractor provided performance and financial data that RMS can conduct each year under the SMC, it does not have a schedule of audits it will conduct and when.

During the first year of the SMC, RMS commissioned some limited audits of financial data. In the first three years of the SMC, RMS did not conduct any audits of performance data. Had there been SMC specific procedures in place, this would have reduced the risk of RMS not implementing a systematic audit program to give it reasonable assurance on the quality of the data that the contractor has provided. This is important because the data is used to measure performance and calculate contractor payments.

RMS has been aware of data quality issues since 2015. While RMS advised that it commenced addressing some data quality issues in response to a series of reviews conducted in 2015, a recent internal audit report indicates that RMS has not resolved the data quality issues.

RMS achieved benefits in the first year, but has not tracked benefits since

As part of the business case, RMS agreed to implement a benefits realisation strategy, including a benefits tracking tool. RMS commenced tracking benefits, but did not establish a comparative baseline pre-SMC on non-financial benefits, and has not tracked benefits past year one.

In 2015, a benchmarking study commissioned by RMS found that it had achieved 80 per cent of the expected recurrent cost savings and other benefits, such as improved workplace safety, in the first full year of the SMC. However, there was no clear baseline to measure non-financial performance. The study was qualified due to gaps in available data. The study also did not reconcile the actual one-off transition costs to the business case estimate.

During the course of the audit, RMS advised that it intends to repeat this type of study to determine whether it has achieved all expected benefits (and their value), and that it would use the results to inform its negotiation with the SMC contractors as part of the commercial reset due in mid-2018.

Recommendations

1. Roads and Maritime Services should consider whether to incorporate stronger sanctions in the Stewardship Maintenance Contract if the contractor provides incorrect performance or financial data to RMS, when:
 - a) negotiating the commercial reset for the next works period with the Sydney region south and west zone contractors due in July 2018
 - b) finalising a new SMC contract for the Sydney region north zone, due to commence in October 2018.

Roads and Maritime Services should, by September 2017:

2. review its contract management framework for SMCs to ensure that all authorities and accountabilities of contract managers are clearly defined, including:
 - a) accountability and procedures for exercising all operational clauses in the SMC where RMS may opt to, or be required to intervene, or make a decision
 - b) authority to approve or initiate the interventions RMS is required to, or may, exercise under the SMC
 - c) the audits that RMS will conduct to systematically validate the performance and financial data that the SMC contractors provide
 - d) the accountabilities of RMS contract managers to systematically review audits and quality reviews that the SMC contractors must conduct to demonstrate compliance with their service plans
 - e) the accountabilities of RMS contract managers to check that the monthly and annual reports provided by SMC contractors do not contain errors, omissions or inaccuracies.
3. improve its management of benefits realisation by:
 - a) initiating a further benefits realisation review and record the benefits delivered against those estimated following the tender process, including the one-off transition costs
 - b) identify any benefits, including savings, not yet attained and develop strategies to address any short-falls
 - c) establish a tool to track the ongoing realisation of benefits.

Introduction

Roads and Maritime Services is responsible for the State Roads network in the Sydney region

Roads and Maritime Services (RMS) is responsible for the Sydney region State roads network. This includes over 2,800 kilometres of roads and associated road corridor infrastructure such as bridges, tunnels and drainage structures. The network is divided into three geographical areas: south, west and north zones. Prior to November 2013, RMS maintained roads in the Sydney region south and west zones through its Road and Fleet Services unit.

In 1995, RMS first outsourced road corridor infrastructure maintenance for the north zone through a Performance Specified Maintenance Contract (PSMC). The current 10-year PSMC for the north zone will expire in October 2018. This contract is worth around \$35 million per annum.

NSW Government priorities and road maintenance

Efficient and effective road maintenance contributes to the following NSW Government priorities:

- improving road travel reliability
- ensuring on-time running of public transport
- reducing road fatalities
- improving government services
- keeping our environment clean.

The NSW Commission of Audit recommended outsourcing the maintenance of State roads

The NSW Commission of Audit in its Final Report on Government Expenditure (May 2012) recommended contestability as an appropriate strategy to consider for improving road maintenance service delivery for State roads.

The Commission benchmarked RMS' road surface quality and cost per lane kilometre against those of Western Australia, Victoria, and Queensland. This showed that New South Wales lagged the other states on both these measures.

Exhibit 1: Interjurisdictional comparison of road maintenance outcomes 2009–10

	WA	VIC	QLD	NSW
Roads managed (lane kms)	52,659	50,510	71,353	80,348
Estimated spend (\$/lane km)	5,000	4,500	6,000	7,000
Road quality measure (%)	99	99	94	91

Source: NSW Commission of Audit Final Report May 2012.

The Commission noted that RMS had conducted two independent reviews to examine the potential for extending road maintenance contestability. The Commission found that there was inadequate and inconclusive benchmarking to establish the efficiency of RMS' Road and Fleet Services unit when compared to outsourcing. It recommended that RMS bring forward a proposal to conduct a competitive tender for the road maintenance of the Sydney region south zone road network to inform the feasibility of a progressive rollout of road maintenance contestability across other areas of the State. In August 2012, the NSW Government adopted the Commission's recommendation.

The NSW Government introduced road maintenance contestability through Stewardship Maintenance Contracts

In April 2013, the NSW Government announced that it would introduce road maintenance contestability across the Sydney region, using a Stewardship Maintenance Contract (SMC) model to improve value for money. In doing so, it excluded RMS' Road and Fleet Services unit from tendering.

The SMC model is based on the following key commercial and performance principles set by RMS:

- performance driven by outcomes
- flexible and adaptable
- transparent and measurable
- linking risk to reward
- continuous improvement
- criteria for selection of, and transition to, different payment models.

The following key stewardship principles underpin the SMC's broad set of values, attitudes and behaviours, which are required of the contractor to effectively manage the assets on behalf of RMS:

- putting RMS' customers (road users and the general public) first and being responsive to them
- being responsible and accountable for the outcomes resulting from the management of the assets
- managing the assets diligently, efficiently and effectively with limited direction from RMS
- working collaboratively with RMS to deliver services that are tailored to meet RMS' evolving needs
- acting with integrity and transparency in performing the services
- performing the services in the best interests of RMS and asset users.

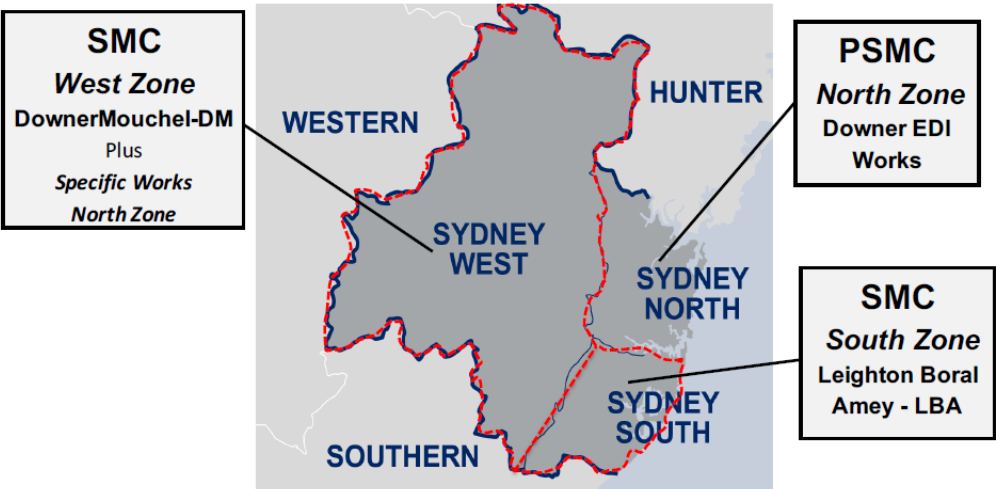
Other key features of the SMC include:

- service requirements which describe the scope of the services, and the standards the contractor must meet
- a commercial framework which defines how payments are structured, how performance assessment will impact on payments and outlines the key commercial principles. SMCs primarily divide payments into two main mechanisms, these being the priced component (or fixed price) and the target cost calculated as follows:
 - fixed price – the contractor is paid a pre-agreed amount for specific services being provided, regardless of the actual costs incurred
 - target cost – RMS and the contractor agree on a target cost for a project, and any cost overruns or underruns are shared between them
- a performance framework which provides mechanisms for assessing contractor performance. This includes a comprehensive listing of the key result areas (KRAs) and key performance indicators (KPIs) against which RMS measures the contractor's performance. The framework also outlines the scoring methodology that RMS uses to determine whether the contractor's bid margin (profit and overheads) is reduced due to less than satisfactory performance or whether a bonus is paid if a threshold performance score is exceeded.

Road maintenance under SMCs for Sydney region south and west zones commenced in November 2013

In November 2013, RMS awarded SMCs to the Leighton Boral Amey consortium, now named Ventia Boral Amey (VBA), for the south zone and the DownerMouchel (DM) consortium for the west zone. The contracts run for seven years with an option for a further three years at RMS’ discretion. In April 2014, full services commenced following a four-month transition period. RMS estimated that the annual cost of these contracts was around \$240 million in total. In March 2018, the contract prices are due to be reset by negotiation to reflect the contractors’ experience with, and better information about, the road networks and routine maintenance requirements.

Exhibit 2: Road maintenance contracts in the Sydney region



Source: Roads and Maritime Services 2015.

Audit scope and focus:

This audit assessed whether RMS had effectively managed the outsourcing of road maintenance in the Sydney region south and west zones. In making this assessment, we answered the following questions:

Audit question	What the audit examined
Did RMS justify the decision to adopt the SMC model?	<p>We looked at how RMS reached the decision that SMCs were the most appropriate contracting model for outsourcing road maintenance in the Sydney region south and west zones. This included whether the RMS business case supporting the adoption of the SMC model was consistent with NSW Treasury guidelines.</p> <p>We also considered whether the KPIs and incentives in the SMC reflected NSW Government and RMS priorities.</p>
Do SMCs include performance indicators (KPIs) and incentives which promote efficiency and effectiveness?	We looked at whether the performance indicators and incentives worked to reduce costs, improve the way road maintenance services were delivered, and improve road quality.
Does RMS collect high quality information on contractor performance and take action to correct performance deficiencies?	We looked at what assurance RMS had that contractor provided performance and financial data was accurate. We also looked at what action RMS took if it finds performance deficiencies.
Are the expected benefits being achieved?	We sought to determine whether RMS could demonstrate that it was achieving the benefits outlined in the business case for adopting the SMC model.

Key findings

1. The Stewardship Maintenance Contract

RMS developed an innovative contracting approach with the SMC. The SMC model includes features that RMS had not previously used for road maintenance contracts. These included adopting stewardship principles and transferring price risk to the contractor over time as the contractor becomes familiar with the assets being maintained.

The SMC model meets RMS' requirements for flexibility in pricing models, the need for collaboration in asset maintenance planning, promoting innovation and effective performance management.

RMS used many good practices to develop the SMC model, including:

- preparing a robust business case comparing the SMC model to RMS maintaining the road network itself, as well as assessing whether two other contracting models (traditional and alliance) would meet its requirements
- assessing experiences with similar arrangements in other jurisdictions and identifying elements that worked to get the best outcomes
- incorporating a robust performance framework, which included a mix of efficiency and effectiveness KPIs that reflected NSW Government policy and RMS priorities
- incorporating risk and reward incentives delivered through cost sharing arrangements to promote efficiency
- using a contract duration that supports RMS priorities and provides an incentive for better quality outcomes.

RMS uses data provided by the contractor to measure performance and calculate payments to the contractor. The SMC includes a specific sanction if RMS finds that the contractor provided incorrect performance data, but no specific sanction if the contractor provides incorrect financial data. If RMS finds that the contractor provided incorrect performance or financial data, RMS can only recover over-payments which may have been made using the incorrect data.

To provide a stronger incentive for the contractor to ensure data it provides is accurate, RMS should consider strengthening the sanctions when negotiating the commercial reset due in mid-2018 for south and west zones. RMS should also consider this for the new contract for the north zone when the current PSMC contract expires in October 2018.

Recommendations

1. RMS should consider whether to incorporate stronger sanctions in the SMC if the contractor provides incorrect performance or financial data to RMS:
 - a) when negotiating the commercial reset for the next works period with the Sydney region south and west zone contractors due in July 2018
 - b) when finalising a new SMC contract for the Sydney region north zone, due to commence in October 2018.

1.1 The SMC business case

RMS justified the decision to adopt the SMC model

RMS prepared a robust business case to justify the decision to use the SMC model to outsource road maintenance in Sydney region south and west zones. RMS also used the business case to secure NSW Government approval to commence the procurement process and to fund the transition costs of outsourcing. The business case addressed how the SMC model would deliver benefits such as cost savings and service delivery improvements. The business case also included estimates of the one-off costs associated with transitioning from in-house provision of road maintenance services, such as redundancy payments.

Non-financial benefits of the SMC listed in the business case included:

- improved customer service
- improved asset performance
- quality data to enhance decision making
- improved road maintenance delivery
- cultivating innovation.

Road maintenance is a program funded through recurrent, rather than capital funding. While there are no NSW Government guidelines for business cases for these types of programs, RMS broadly complied with NSW Treasury Guidelines for Capital Business Cases (Policy and Guidelines Paper TPP 08–5). At the time, NSW Treasury did not require gateway reviews of business cases for recurrently funded programs.

In selecting the stewardship contract model, RMS considered experiences with similar arrangements in other jurisdictions, such as New Zealand and the United Kingdom. RMS also reviewed extensive research on outsourcing road maintenance. The SMC model effectively meets RMS' requirements for flexibility in pricing models, the need for collaboration in asset maintenance planning, promoting innovation and effective performance management.

RMS considered two alternative contracting approaches: alliance contracts (where alliance partners share all outcomes) and traditional contracts (where risk is allocated to each party). Neither of these alternatives met all its requirements.

1.2 The SMC includes performance measures and incentives to drive efficiency and effectiveness with opportunity for improvement

The SMC performance framework primarily drives effectiveness

The SMC includes a performance framework with mechanisms to regularly assess the contractor's performance. This framework, based on seven key results areas (KRAs) and 17 key performance indicators (KPIs), is designed to drive contractor performance, with a contractor's overall margin (profit and overheads) at risk through a risk and reward arrangement. Of the 17 KPIs, 16 are effectiveness measures.

The performance framework is based on the following performance measurement principles:

- alignment with NSW Government and RMS policies such as road quality
- consistent performance measurement across different service providers for different zones
- a risk reward payment mechanism aligned with RMS performance requirements
- contractors encouraged to take a stewardship role over the road network and be involved in defining and delivering good performance
- be simple and practical and not require undue effort to manage
- flexibility to allow adjustments based on lessons learnt, performance of the contractor and RMS, and changes to NSW Government policy or RMS strategy.

Each KRA has specific KPIs to score the contractor's performance. Most of the KPIs have objective measures. RMS weighted each KRA and KPI to reflect their relative importance to achieving NSW Government and RMS priorities. While the contractor provides performance data for over half of the KPIs, RMS supplied or verified data impacts on around half of the overall performance score due to the weighting set by RMS.

Exhibit 3: Stewardship Maintenance Contract Key Result Areas and Key Performance Indicators

KRA	Max Score	KPI	Weight %	Measures >Source of data
Stewardship	5	1. Overall performance	--	Subjective / Effectiveness >Joint
		2. Compliance with Road Occupancy Licence	--	Objective / Effectiveness >Contractor
		3. Response to natural disasters and weather events	--	Objective / Effectiveness >Contractor
		4. Response to safety hazards	--	Objective / Effectiveness >Contractor
Customer experience	15	5. Customer engagement and consultation	40	Objective / Effectiveness >Contractor
		6. Customer complaints made	30	Objective / Effectiveness >Contractor
		7. Response to customer complaints	30	Objective / Effectiveness >Contractor
Network outcomes	10	8. Incident management	100	Objective / Effectiveness >Contractor
Environment	5	9. Environment management	100	Objective / Effectiveness >RMS
Asset outcomes	40	10. Smooth travel exposure	35	Objective / Effectiveness >RMS
		11. Road surface cracking	20	Objective / Effectiveness >RMS
		12. Road surface rutting	20	Objective / Effectiveness >RMS
		13. Skid resistance	25	Objective / Effectiveness >RMS
Program governance	20	14. Compliance with contract requirements	40	Objective / Effectiveness >RMS
		15. Relationship	30	Subjective / Effectiveness >Joint
		16. Safety	30	Subjective and objective / Effectiveness >Contractor
Efficiency	10	17. Time performance of projects	100	Objective / Efficiency >Contractor

Source: Roads and Maritime Services 2013.

The SMC duration is separated into three consecutive works periods of one year, three years and three years. The KRAs and KPIs are fixed for each works period, but can be amended by agreement for each new works period. To date, there has been one amendment to make the efficiency KPI more specific. RMS and the contractors are considering other amendments to KPIs for the start of the next works period in July 2018. These include increasing the number of milestones to be measured for the efficiency KPI, and amending the measurement methodology for the KPIs in the asset outcomes KRA.

RMS and the contractor agree on the KPI score against each of the KRAs at the end of each year, resulting in an overall performance score. The SMCs include a performance incentive regime which puts a proportion of the contractor's overall margin at risk if the contractor does not achieve a specified overall performance score. If the overall performance score exceeds the specified threshold, the contractor can claim bonus payments. To further drive effectiveness, the SMC includes an increase in the specified threshold score at the end of the initial works period.

The SMC pricing mechanisms drive efficiency

The SMC includes three pricing mechanisms that drive efficiency: target cost payments; transferring work to fixed price payment over time; and an efficiency commitment by the contractor to reduce prices by a defined amount over time.

The first pricing mechanism is target cost. The SMC primarily uses a mix of fixed price and target cost payment types. The payment type used depends on the price predictability of the services that the contractor performed, which can change as the contract matures, or may depend on the type of service.

Under target cost payment, RMS and the contractor negotiate a target cost for a specific service. If the actual cost exceeds the target cost, RMS pays the contractor the actual cost incurred (including margin), less 50 per cent of the cost overrun. If the actual cost is less than the target cost, then the contractor keeps 25 per cent of any underspend, with another 25 per cent of the underspend transferred into a performance incentive pool. RMS keeps the remaining 50 per cent. RMS can verify the contractor's actual costs through an 'open book' arrangement, where the contractor gives RMS access to all its cost data.

The contractor can qualify for additional payments from the incentive pool if its annual overall performance score under the performance framework exceeds the specified threshold. This performance incentive payment can reach a maximum of \$1.5 million per year. The amount payable will depend on the total in the incentive pool, and the annual overall performance score the contractor achieves. Conversely, if the contractor fails to achieve the specified threshold overall performance score, then RMS can reduce the contractor's overall margin for that year by up to 75 per cent. The amount of the reduction will depend on the annual overall performance score the contractor achieves.

Exhibit 4: Target cost payments - benefits and risks

The target cost payment method includes risk and reward sharing to encourage greater efficiency by a contractor on delivering services. The contractor's ability to retain a proportion of any underspend of the target cost, or needing to meet a portion of overspend, can act as a strong incentive for the contractor to drive costs out of providing services.

In the SMC, RMS applies this payment method in situations where the scope of services is relatively well defined, but there are risks which can be best managed by the contractor, and/or there are risks which would attract a premium if payment was on a fixed price basis.

However, this payment method also brings significant risks to RMS if not managed well. Firstly, it can be reasonably expected that a contractor will seek to negotiate the highest possible target cost for the service. This will create the greatest potential for underspending and hence retention of a portion of that underspend, or provide an inflated buffer with which the contractor can mitigate losses due to overspending. To avoid this outcome, RMS needs to have adequate numbers of skilled cost estimators who can negotiate target costs for services from a strong knowledge and experience base. Otherwise, the potential efficiency benefit could be lost.

Secondly, the target cost payment method is based on reimbursing the contractor for actual costs incurred (subject to risk/reward additions or subtractions). As a result, any costs the contractor claims which are not genuinely attributable to the specific service will provide an improper benefit to the contractor. While the SMC requires the contractor to provide RMS with complete access to all financial information, RMS must ensure that it verifies the claimed actual costs to avoid being overcharged.

Source: Audit Office research 2017.

The second pricing mechanism is moving more work to fixed price payment over time. RMS can transfer certain types of maintenance work from target cost to fixed price, as the SMC matures and the contractor becomes more familiar with the road network. This has the effect of transferring additional risk to the contractor, thereby promoting efficiency. For the initial 12-month works period, fixed price was only used for program management and asset management services, which represented around eight to nine per cent of the contract value. In the next (three-year) works period, the routine maintenance and pavement rehabilitation categories of road maintenance transitioned from target cost to fixed price, with the fixed price amounts negotiated by RMS and the contractor. This resulted in fixed price payments increasing to between 38 and 44 per cent of contract value. In the final three-year works period, due to start in July 2018, the service categories of simple minor improvement works and event management will also transition from target cost to fixed price.

The final pricing mechanism is an efficiency commitment. The SMC required the contractor to reduce their prices and rates for services by an agreed percentage for each works period. The first of these commercial resets occurred in mid-2015. Also, RMS can benchmark a contractor's performance against similar services being performed in other zones and in other jurisdictions. Under the SMC, RMS can use the benchmarking when negotiating target costs and when categories of maintenance work are transferred from target cost to fixed price.

RMS should consider whether to incorporate stronger sanctions if the contractor provides incorrect data

RMS uses data provided by the contractor to measure performance and calculate payments to the contractor. The SMC includes a specific sanction if RMS finds that the contractor provided incorrect performance data, but no specific sanction if the contractor provides incorrect financial data. If RMS finds that the contractor provided incorrect performance or financial data, RMS can only recover over-payments which may have been made using the incorrect data.

In the previous section, we explain how the target cost payment can drive efficiency improvements. This relies on the quality of financial data the contractor provides to RMS. It is important that the RMS considers what additional incentives for the contractor to provide accurate financial data to RMS may be needed, as this can affect both the negotiated target cost and the actual payment for the work.

2. RMS' contract management approach and benefits realisation

RMS has established a contract management framework which includes most elements of good practice, including governance and dispute resolution mechanisms. However, RMS' management of the SMC has key elements missing which reduces its effectiveness. RMS realised some benefits in the first year of the SMC, including savings in service delivery costs. However, RMS has not tracked its achievement of benefits since then.

RMS does not have SMC specific contract procedures to guide its contract managers. Consequently, RMS has not exercised several significant SMC requirements, such as having the contractors account for an efficiency dividend in their pricing at the start of each three-year works period. Effective contract management should be supported by contract specific procedures, with explanations of, and allocation of responsibility for, the various interventions that RMS may be required to exercise in the SMC.

Performance and financial reporting under the SMC is based on a mix of RMS and contractor provided data. While there are a range of audits of the contractor provided performance and financial data that RMS can conduct each year under the SMC, it does not have a schedule of audits it will conduct and when. During the first year of the SMC, RMS commissioned some limited audits of financial data. In the first three years of the SMC, RMS did not conduct any audits of performance data. Had there been SMC specific procedures in place, this would have reduced the risk of RMS not implementing a systematic audit program to give it reasonable assurance on the quality of the data that the contractor has provided. This is important because the data is used to measure performance and calculate contractor payments. RMS has been aware of data quality issues since 2015. While RMS advised that it commenced addressing some data quality issues in response to a series of reviews conducted in 2015, a recent internal audit report indicates that RMS has not resolved the data quality issues.

In 2015, a benchmarking study commissioned by RMS found that it had achieved 80 per cent of the expected recurrent cost savings and other benefits in the first full year of the SMC. However, there was no clear baseline to measure non-financial performance. During the course of the audit, RMS advised that it intends to repeat this type of study to determine whether it has achieved all expected benefits (and their value), and that it would use the results to inform its negotiation with the SMC contractors as part of the commercial reset due in mid-2018.

Recommendations

RMS should, by September 2017:

2. review its contract management framework for SMCs to ensure that all authorities and accountabilities of contract managers are clearly defined, including:
 - a) accountability and procedures for exercising all operational clauses in the SMC where RMS may opt to, or be required to intervene, or make a decision
 - b) authority to approve or initiate the interventions RMS is required to, or may, exercise under the SMC
 - c) the audits that RMS will conduct to systematically validate the performance and financial data that the SMC contractors provide
 - d) the accountabilities of RMS contract managers to systematically review audits and quality reviews that the SMC contractors must conduct to demonstrate compliance with their service plans
 - e) the accountabilities of RMS contract managers to check that the monthly and annual reports provided by SMC contractors do not contain errors, omissions or inaccuracies.
3. improve its management of benefits realisation by:
 - a) initiating a further benefits realisation review and record the benefits delivered against those estimated following the tender process, including one-off transition costs
 - b) identify any benefits, including savings, not yet attained and develop strategies to address the shortfalls
 - c) establish a tool to track the ongoing realisation of benefits.

2.1 Contract performance and financial monitoring

Financial and performance reporting is based on a mix of RMS and contractor provided data

The contractor reports to RMS monthly on its progressive KPI performance, and annually on its overall performance score which determines the margin payable. To determine the payments the contractor receives for providing services under the target cost method, RMS can access data supporting the contractor's target cost estimates and actual costs incurred.

The SMC requires the contractor to have an integrated contract management system that includes operational plans, processes and procedures. The contractor must give RMS access to this system for monitoring and auditing.

The integrated contract management system contains 25 service plans detailing how the contractor will carry out its service delivery obligations. The service plans must use RMS standard specifications for general and technical requirements. The contractor warrants that the service plans comply with RMS requirements and are fit for purpose, and RMS relies on this warranty.

Transparency is one of the principles in the SMC to embed trust and to ensure that RMS remains an informed asset owner. All key contractual information, including financial and performance data, is to be fully transparent and conducted on an 'open book' basis between RMS and the contractor. This is particularly important as contractor provided data impacts on around half of the overall performance score which determines margins and performance incentive payments and on around half of overall contractor payments.

The SMC enables RMS to effectively audit and oversee contractor performance

The SMC gives RMS the authority to audit and oversee the contractor's performance, including:

- monthly meetings with the contractor to discuss performance and to reach agreement on KPI scores for the month
- annual performance reviews with the contractor to discuss performance and to reach agreement on the overall performance score
- access to the contractor's workplaces, information, records and personnel to review, conduct surveillance and audit the contractor's procedures, activities and compliance with SMC requirements
- auditing, inspecting and carrying out surveillance of the contractor's:
 - performance against KPIs and KRAs
 - compliance with systems, processes and procedures specified in the SMC
 - records and data to verify accuracy of any data, reports and payment claims provided to RMS.

RMS has not done enough to validate the performance and financial data provided by the contractors

RMS conducted some limited audits of financial data supporting payments made to the contractor in the first year of the SMC, but no audits of performance data to date. Several financial audits reported that contractor provided data did not meet quality standards. Internal audits of RMS' contract management practices for the SMC also identified data quality issues. While RMS commenced addressing some data issues, these have yet to be fully resolved. This is important because the data is used to measure performance and calculate contractor payments.

RMS commissioned two internal audits of its SMC contract management practices.

Two key issues identified in the first report (March 2015) were that a contract management framework was yet to be documented, and that RMS should improve its document management practices. During the course of the audit, RMS advised us that it had completed the management actions to address these findings.

The second report (December 2016) identified the following issues:

- 45 per cent (125 out of 280) of projects were commenced before an agreed target cost had been recorded
- the quality of milestone and financial data in the integrated contract management system, used to prepare monthly reports, was deficient
- there was no clarity regarding what processes had been undertaken by RMS contract managers to independently verify the accuracy of reported KPI scores
- RMS contract and commercial managers did not closely review monthly invoices submitted by contractors to identify anomalies or overcharging.

RMS advised that it plans to address the issues raised in the December 2016 report by 30 June 2017. The outstanding issues from these financial and internal audits puts in doubt the reliability of the data used to measure performance and calculate contractor payments in the first three years of the SMC.

A key finding in the March 2015 report was that RMS did not have a structured process in place on how it would assess performance data. In response, RMS agreed to document and implement a structured process for assessing monthly performance data received from the contractor. However, in line with the findings in the December 2016 internal audit report, we found no evidence that RMS systematically verifies the accuracy of reported KPI scores.

Our analysis of documentation and interviews with RMS contract management staff reinforced many of the findings in the December 2016 internal audit report. While RMS advised it used external reviews to test the validity of progress claims made by the contractor, these reviews ceased after the 2014–15 financial year. RMS also does not routinely interrogate the data that the contractor provides on its monthly performance outcomes. RMS specialist areas provided some level of verification for KPIs dealing with environmental management and customer engagement.

RMS initiated independent reviews to test the veracity of payment claims made by the contractors for projects completed in 2014–15 financial year under the target cost payment mechanism. The reviews sampled claimed reimbursable costs made for 54 south zone projects costing around \$30 million, and 53 west zone projects costing around \$40 million.

The west zone review found that nothing had come to the attention of the review to indicate that, in all material respects, actual costs (in total) were not verified. However, the review did raise matters that limited its ability to perform and conclude on certain procedures at transaction detail level, and which raised future risks to project outcomes. These included:

- an inability to verify the accuracy and validity of labour charges recorded in the contractor's project ledger
- lack of transparency of claimed overhead costs
- inconsistent application of calculations and formulas by the contractor.

The south zone review concluded that it had not been provided with sufficient information to determine that, in all material respects, actual costs were successfully verified for the contractor's target cost projects. The key issue was the inability of the contractor to provide evidence of actual costs incurred.

In response, RMS advised that the south zone contractor was implementing a new financial management system to address the problems identified. RMS has not indicated when the contractor will complete this implementation.

As both reviews raised issues with the quality of financial data that the contractor provided, together with the findings of the RMS December 2016 internal audit report, we conclude that RMS has yet to effectively resolve the data quality issues first identified in 2015.

2.2 RMS' contract management framework

RMS' management of the SMC has key elements missing which reduces its effectiveness

Effective contract management requires a contract management framework that addresses governance arrangements, skills, roles and responsibilities, and policies and procedures. It should promote accountability for decision making and expenditure of public funds. Our research identified nine key elements that we first published as a better practice contract management framework in 'Managing IT Services contracts' (February 2012). Details of the better practice contract management framework are in Appendix 2.

RMS has a contract management framework that includes most elements of the better practice contract management framework, including:

- appropriate reporting and oversight practices are in place
- independent monitoring of contracts to check compliance and identify weaknesses
- roles and responsibilities of RMS and the contractor are clear
- a whole of agency procurement manual with policies and procedures
- established capability to manage the contract.

However, key elements of the better practice contract management framework are missing. Effective contract management should be supported by contract specific procedures, with explanations of, and allocation of responsibility for, the various interventions RMS may be required to exercise in the SMC.

RMS does not have SMC specific procedures to guide its contract managers.

RMS' accreditation under the Agency Accreditation Scheme for Construction enables it to carry out most procurement without oversight from the Department of Finance, Services and Innovation. A key condition of accreditation is that it must have contract administration procedures in place.

The SMC is relatively new and very complex and RMS does not provide clear guidance to its contract managers explaining how, when and who can deal with the many mandatory and optional interventions (over 90 in the general conditions alone) RMS may exercise in managing the SMC. There are many other potential interventions in the 24 schedules that make up the SMC. While RMS has implemented a maintenance contract management framework, its framework does not include SMC specific procedures.

SMC specific contract management procedures may have prevented the following failure by RMS to exercise significant requirements in the SMC. The SMC includes a provision to promote efficiency by requiring the contractor to tender specific percentage reductions in its pricing for services for each of the three-year works period following the initial works period. This is called the 'efficiency commitment'. The contractor needs to demonstrate to RMS how it has accounted for the efficiency commitment when pricing its services for the upcoming three-year works period. This is important because the contractor sets the service pricing at the beginning of each works period.

However, when pricing services for the first three-year works period, which commenced in July 2015, RMS did not require either contractor to demonstrate how it had accounted for the efficiency commitment. Contrary to the intent of the SMC, RMS advised it will conduct this process at the end of the current works period ending in June 2018. This approach presents a risk that RMS will not know whether the contractor had reduced its prices in line with its efficiency commitment. RMS is waiting three years to find out and will then have to recover any price reductions for that works period.

Having SMC specific procedures in place would also have reduced the risk of RMS not implementing a systematic audit program to validate the data that the contractor provided to support performance outcomes and payment claims.

In line with the better practice contract management framework, we also expected that RMS would have contract specific allocation of responsibilities to exercise key clauses in the SMC.

RMS provided a copy of its corporate financial delegations, but these were high level and did not reference the SMC. The consequence is that accountability for initiating audits of the data that the contractors provide to RMS is unclear and increases the risk that audits will not be systematically conducted.

There are other areas where RMS should improve its contract management practices. The SMC contractor must prepare and comply with 25 service plans defining required services. The plans include contractor initiated quality assurance audits. While this is good practice, RMS has not systematically reviewed whether either contractor conducted these audits, and whether they had effectively addressed any issues raised.

The annual report, prepared by the contractor, is a key document which supports RMS' annual review of individual KPIs and the overall performance scores. The monthly report, also prepared by the contractor, acts as a record of agreement between the contractor and RMS on the progressive assessment of KPI scores. We found that some reports contained obvious inaccuracies or omissions, and RMS had not validated the performance information reported, despite endorsement by RMS' contract manager.

RMS has not done enough to validate overall performance scores

Under the performance framework, RMS and the contractor agree on the overall performance score at the end of each year financial year. The SMC includes a performance incentive regime which puts up to 75 per cent of the contractor's overall margin at risk if the contractor does not achieve a specified overall performance score. If the overall performance score exceeds the specified threshold, RMS can make bonus payments. To further drive effectiveness, the threshold score for bonus payments increased at the end of the initial works period.

For the at-risk margin, RMS pays the full margin if the overall performance score reaches the threshold of 70 points or more. If the score is below 30, then RMS does not pay 75 per cent of the margin. Scores between 30 and 70 result in a pro-rata adjustment to the at-risk margin. To promote performance improvements over time, the threshold score was set at 70 in year one, and 75 in subsequent years.

In each of the two completed years of the SMC, both contractors achieved overall performance scores greater than the specified thresholds at which their margins are reduced.

Exhibit 5: Overall performance scores

Year	South zone	West zone	Threshold
2014–15	85.61	87.32	70
2015–16	81.39	88.26	75

Source: Roads and Maritime Services 2017.

Despite the overall performance score results, the contractors have reported, and addressed performance deficiencies progressively as they occurred. This is in line with the way RMS incorporated performance incentives in the SMCs. These incentives act to encourage the contractor to report, and respond quickly to, performance shortcomings, minimising the need for RMS to intervene.

However, the underlying risk remains that the overall performance score is only as good as the quality of the data used to calculate the individual KPI scores. With the issues around the quality of contractor supplied data being unresolved, RMS cannot assure us that a contractor's overall performance scores are robust.

2.3 Benefits realisation

RMS achieved benefits in the first year, but has not tracked benefits since then

A benchmarking study that RMS commissioned for the 2014–15 financial year showed that it had achieved cost savings for service delivery in the first year, and these were around 80 per cent of cost savings estimated by RMS following the completion of the tender process. The SMCs had achieved a 5.5 per cent recurrent cost reduction compared to expected net savings of 6.9 per cent. RMS has not tracked benefits since then.

In calculating the savings for direct cost items, the study acknowledged that there were gaps in available data which resulted in elements of work either being excluded, or relying on data sampling.

The study was not able to assess the non-cost benefits outlined in the business case, as RMS had not establish a comparative baseline pre-SMC. These benefits were:

- improved customer service
- improved asset performance
- quality data to enhance decision making
- improved road maintenance delivery
- cultivating innovation.

The study also did not compare the actual one-off transition costs to those outlined in the business case.

In the business case, RMS proposed to monitor success and assign ownership of the benefits. This included establishing a benefits tracking tool. To date, RMS has not implemented the proposed benefits tracking tool.

The benchmarking study also reviewed whether the SMC effectively achieved:

- innovation and change implementation
- information availability and accuracy
- Transport Management Centre satisfaction (RMS client)
- Journey Management satisfaction (RMS client)
- KPI performance.

Overall, the study found that the SMC delivered improved performance. However, the improvements related to either the contract structure (having a comprehensive set of KPIs) and improvements on performance from the start of the SMC to the time of the study, rather than being compared to the previous operating model. The only KPI the review was able to compare to pre-SMC was for safety. This showed marked improvement in the total recordable injury frequency rate by the two zone contractors in 2014–15, when compared to not only Sydney region, but also to Hunter and Southern regions on RMS performed road maintenance in 2012–13.

Exhibit 6: Total Recordable Injury Frequency Rate score comparison

Measure	South zone	West zone	Sydney region	Hunter region	Southern region
	2014–15		2012–13		
TRIFR	19.6	5.11	56.59	45.31	57.25

Source: Roads and Maritime Services 2015.

During the course of the audit, RMS advised that it intends to repeat this type of study to determine whether it has achieved all expected benefits (and their value), and that it would use the results to inform its negotiation with the SMC contractors as part of the commercial reset due in mid-2018.

Appendices

Appendix 1: Response from Roads and Maritime Services



Your ref: PA6592
Our Ref: M17/0390

Ms Margaret Crawford
Auditor-General of NSW
Audit Office of New South Wales
GPO Box 12
SYDNEY NSW 2001

Dear Ms Crawford

Performance Audit Report – Sydney Region Road Maintenance Contracts

Thank you for the opportunity to respond to the final report on the Performance Audit of Sydney Region Road Maintenance Contracts, which was provided to the Transport cluster on 26 May 2017.

The audit has acknowledged that Roads and Maritime Services was justified in adopting the Stewardship Maintenance Contract approach to the outsourcing of road maintenance within the Sydney region and has achieved cost savings as a result. It has also confirmed the performance framework and pricing mechanisms established through the contracts operate to drive efficiency and effectiveness.

In managing the contracts, Roads and Maritime has established a comprehensive contract management framework that has been independently reviewed as fit for purpose. Roads and Maritime is committed to continually improving the management of the contract arrangements and has commissioned a number of studies and internal audits that have confirmed benefits realised and provided assurance that the management of the contracts maximises road maintenance outcomes across Sydney.

The Transport cluster has noted the recommendations in the report.

Yours sincerely

A handwritten signature in black ink, appearing to be "TR", written over a horizontal line.

Tim Reardon
Secretary, TfNSW

7 JUN 2017

A handwritten signature in black ink, appearing to be "K. Kanofski", written over a horizontal line.

Ken Kanofski
Chief Executive, RMS

7 June 2017

Transport for NSW

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Appendix 2: Better practice contract management framework

Effective contract management requires an appropriate contract management framework that addresses governance arrangements, skills, roles and responsibilities, and policies and procedures. It should promote accountability for decision making and expenditure of public funds. Our research identified nine key elements that we first published as a better practice contract management framework in 'Managing IT Services contracts February' 2012.

Better practice element	Comment: What is required and why
Governance	Define oversight, financial and management controls
Agencies' contract management delegations are clear and consistent with general financial delegations	<ul style="list-style-type: none"> Agencies' general financial delegations should take precedence over contract management delegations, such as signing the contract. Contract management delegations should escalate based on the risks, value and/or duration of the contracts being managed. Contract management delegations should provide clarity and control the exercise of key decisions such as contract variations and time extensions. <p>Intent</p> <p>It is important that contract management delegations are clear and consistent with general financial delegations. General financial delegations are designed to ensure that any new financial commitments are approved at appropriate levels. While general financial delegations give authority to making financial commitments, contract management delegations give authority to undertaking administrative tasks, such as signing contracts. These functions should be segregated.</p> <p>Long term services contracts, particularly for IT, typically may have an initial duration, with several options to extend which can be unilaterally exercised by the agency. This gives the agency flexibility to either remain with the original supplier if performing well, or return to the marketplace. This arrangement can save the agency costs associated in bringing on board a different supplier.</p> <p>However, if the option to extend is to be exercised, a value-for-money assessment should be completed. A further approval is required under financial delegation if such an action commits the agency to new expenditure.</p>
Appropriate reporting and oversight practices for contract management are in place	<ul style="list-style-type: none"> Defines who reports what to whom and how often, and must be based on contract risk, volume, value, and duration of contracts being managed. The reporting must recognise critical changes/exceptions to approved budget value and duration (traffic lights), such as cumulative variations above preset thresholds of contract value. Greater skilling, training, and independent expert support available for members of agency steering committees and others with management oversight responsibilities for IT services contracts. At least once per year the Audit and Risk Committee should review the contract register. <p>Intent</p> <p>Appropriate reporting and oversight should be in place for contract management, which includes oversight outside the business unit that 'owns' the contract.</p> <p>Well structured and targeted reporting on contract and supplier performance ensures appropriate key agency personnel are provided with the necessary information for decision making. For example, how a supplier is performing in meeting its service level obligations is a key performance indicator of the health of a contract, which would be of interest not only to personnel closely associated with the contract but also to senior management outside the business unit. The way the contract and supplier are performing would also be of interest to management, particularly when considering proposals to renew or extend</p>

Better practice element	Comment: What is required and why
	<p>existing contracts. Financial information such as predicted cash flows, estimated final cost and approved variations should be reported on regularly.</p> <p>The SCCB would also have an interest in both supplier and contract performance where it relates to agency contracts for purchases from State contracts.</p>
The investment required to manage contracts is assessed and committed	<ul style="list-style-type: none"> • Agencies need to decide how to organise procurement and contract management functions based on the structure of the organisation, and whether procurement activities will be centralised or decentralised, or a combination. • Agencies have completed an assessment of capability and how to acquire and maintain skills and capability to ensure the right people are in place to carry out contract management activities. • Agencies capability assessment addresses the structure of the organisation, and the volume and risk profile of current and planned contract management activities. This may be centralised vs decentralised and from where contract management capability is to be sourced (in-house, external). • Agencies have the ability to capture key data on contractor performance and lessons learnt from previous experience, and respond accordingly in improving contract management arrangements. <p>Intent</p> <p>Agencies must establish the capability required to effectively manage contracts. This means that agencies review the types, value and number of contracts that need to be managed and the risk to the agency of poor contract management. Agencies then assess the resources required to adequately manage their procurement and contract management activities, which include:</p> <ul style="list-style-type: none"> • performance monitoring and management • fulfilling contractual obligations • supplier relationship management • risk assessment and management. <p>Industry benchmarks estimate that organisations should invest between three and seven per cent of the contract value to manage complex contracts where there are high switching costs or time to switch, and where there is low market competition for the services provided.</p> <p>In some agencies this will mean establishing a specialised procurement group. This group would be responsible for developing, and monitoring compliance with agency procurement policies and procedures, as well as centrally managing major contracts and monitoring industry benchmarks. In other agencies the investment will be in skills and capabilities of selected positions to manage specific contracts.</p>
Agencies regularly review their contract management framework for relevance and that it is operating as intended	<ul style="list-style-type: none"> • Agencies regularly review the governance framework and policies for compliance with government and agency procurement policies. This could be a role for the Audit and Risk Committee. • Performance against procurement function strategy and procurement management plan. <p>Intent</p> <p>Agencies should regularly review their contract management framework for relevance and to ensure that it is operating as intended. Agency structures and government policies governing procurement change over time and the framework must be updated in line with these changes to ensure contracts continue to be appropriately managed and controlled.</p>

Better practice element	Comment: What is required and why
<p>There is independent internal monitoring of individual contracts to check compliance</p>	<p>IT services contracts can be complex and long-term arrangements. Circumstances may change over time, such as governance and management arrangements, and staff changes in the agency. Agencies may be moving from simple purchase of goods to more complex and long term services contracting arrangements. They will need to ensure their framework is adequate to respond to this transition.</p> <p>This is an appropriate role for Audit and Risk Committees.</p> <ul style="list-style-type: none"> • Ensure independent internal monitoring to ensure that individual contracts are managed effectively. This should be a role for the internal audit function. <p>Intent</p> <p>There should be independent monitoring of contracts to check compliance with contractual obligations and agencies' contract management framework in order to identify weaknesses. This is an appropriate role for agencies' internal audit programs.</p> <p>Through agency Audit and Risk Committees and internal audit programs, independent monitoring can provide an objective process to ensure contract management frameworks comply with government, agency and business unit policies and procedures. They can also provide guidance on the effectiveness of such frameworks which can result in improvements over time.</p>
Roles and responsibilities	Define who does what
<p>Roles and responsibilities are determined and assigned</p>	<ul style="list-style-type: none"> • Agencies have determined and assigned the various tasks and responsibilities required for contract management and allocated these to the appropriate roles: For example, who manages the supplier relationship, who reports to senior management, what is reported to the Audit and Risk Committee. • Agencies have determined and assigned the various roles required for contract management. For example, contract owner, contract manager, contract administrator, etc. • Agencies may use resources, such as the ANAO Better Practice Guide or PACCER Contract Management Self Assessment tool, as a checklist for identifying contract management tasks. <p>Intent</p> <p>Agencies must ensure that contract management roles and responsibilities are clear. This means understanding the responsibilities and tasks required to effectively manage contracts, and assigning these responsibilities to the appropriate positions.</p> <p>Appropriately skilled people and the right management structure, supported by comprehensive contract specific guidance material, can strengthen compliance with agency governance frameworks, and better manage gaps in agency policies and guidance. Technical expertise alone is not sufficient to provide the capability required for managing complex services contracts, which typically also require commercial and contractual skills.</p>
<p>The skills and experience required to manage each contract are assessed and sourced</p>	<ul style="list-style-type: none"> • Agencies must match and source the contract management skills and competencies required to manage each contract based on the assessed contract risk (see policies and procedures). <p>Intent</p> <p>Agencies must assess the skills and experience required to manage each contract. Each contract should be matched to the level of contract management skills that is needed to manage it effectively and achieve value for money.</p>

Better practice element	Comment: What is required and why
	<p>Typical contract management skills</p> <p>Contract specific skills</p> <ul style="list-style-type: none"> • Specific subject matter/industry knowledge • Involvement in similar contracts • Knowledge of specific client groups. <p>General contract management skills</p> <ul style="list-style-type: none"> • Project management • Interpersonal and liaison • Supplier relationship management • Negotiation • Business acumen • Performance monitoring and analysis • Risk management • Problem resolution/problem solving • Team management/team motivation • Secretariat support • Visual presentation – graphs and diagrams • Budgeting, financial management • Legal aspects of contracting and procurement • Document management. <p>Having skilled and competent personnel with defined responsibilities managing legally and technically complex, long term and high value IT services contracts is essential to extract optimum performance and value for money.</p>
Policies and procedures	Define what is done, how it is done and when it is done
<p>There is a whole of agency procurement manual that includes contract management policies and procedures</p>	<ul style="list-style-type: none"> • Developed and promulgated by the owner of procurement policy in agencies. • Complies with NSW Government Procurement policies, the <i>Public Finance and Audit Act 1983</i>, the NSW Government Procurement Goods and Services framework, and the agency's internal policies and procedures (governance, management, reporting, etc). • The manual should cover contract management processes, such as: <ul style="list-style-type: none"> – maintaining a contract register – assessing and managing risk – keeping appropriate records – complying with government procurement policies and the Public Finance and Audit Act – effective and timely performance monitoring – effective and timely reporting – preparing value for money assessments, including business needs analyses and market testing, to justify contract renewals, extensions, exercising options, new contract with same supplier for the same service, or where ever there is to be direct negotiations – dispute management – transitional arrangements and starting/ending the contract.

Better practice element

Comment: What is required and why

- Major business units may also need to develop their own procurement manual that complies with the whole of agency procurement manual.

Intent

Agencies should develop comprehensive procurement guidance material that includes contract management policies and procedures at the agency and business unit level. The guidance should set out the rules for managing contracts, the minimum standards expected of contract managers and how to achieve value for money.

Issues such as access to complete contract documents and the need to maintain comprehensive records of actions and approvals need to be covered.

Each contract has a risk based contract management plan

- A contract management plan should be developed whether buying off state contracts or where the agency has established its own contracts.
- A risk based contract management plan will customise its content and level of detail based on the agency's risk assessment of the contract, its contract management capabilities, and its risk management framework.
- A contract management plan contains information, such as:
 - key information about how a contract will be resourced and managed to comply with contract management policies and procedures
 - risk assessment and risk management strategy
 - transitional arrangements: starting, ending and extending or renewing the contract
 - a commentary or guide explaining operational clauses
 - systems and processes to ensure that the agency and the contractor complies with the terms and conditions during the performance of the contract
 - roles and responsibilities of both the agency and contractor
 - reporting requirements and oversight arrangements
 - actions to be taken at periodic contract review points, and at decision points to extend or renew contracts, to assess changing business needs, service delivery and value for money
 - detail on how to effectively monitor and manage performance against the contract objectives, service delivery standards and KPIs.

Intent

Each contract should have a contract management plan. This sets out key information about contract obligations and milestone dates, as well as the process for managing specific contract clauses. This should assist contract managers to understand the intent and operation of the contract and ensure that contract managers are not left to interpret contract clauses. This will support consistent and correct actions over time, particularly where staff changes occur.

A contract management plan will also incorporate information such as how the contract will be resourced and managed, assessing and managing risks, roles and responsibilities of the contracting parties and reporting requirements.

Appendix 3: About the audit

Audit objective

This audit assessed whether Roads and Maritime Services (RMS) has realised the expected benefits of outsourcing road maintenance for the Sydney region south and west zones under Stewardship Maintenance Contracts (SMC). This objective covers:

Effectiveness:

- do SMC KPIs and performance incentives achieve RMS' and the NSW Government's objectives?
- have SMC KPI targets been achieved?

Efficiency and economy:

- has the net cost of road maintenance for Sydney region south and west zones fallen?

Audit criteria

We addressed the audit objective by assessing whether:

1. RMS justified the decision to adopt the SMC model
2. SMCs include performance indicators and incentives which promote efficiency and effectiveness
3. RMS collects high quality information on contractor performance and takes action to correct performance deficiencies
4. expected net benefits are being achieved.

Audit scope and focus

The scope was limited to RMS' actions regarding the outsourcing of road maintenance services under the SMC for the Sydney region south and west zones, from October 2012 to the present.

A key focus of the audit was the extent to which RMS achieved the expected benefits, net of the costs of implementation. That is, the extent to which road maintenance has improved and costs have fallen compared to previous road maintenance arrangements through Road and Fleet Services and RMS targets.

Audit exclusions

The audit did not:

- examine the market testing process used by RMS to select the two consortia to provide road maintenance services under the SMC
- examine the internal efficiency of the private sector consortia delivering the services under the SMCs (this is beyond mandate)
- question the merits of NSW Government policy objectives.

Audit approach

Our procedures included:

1. Interviewing:
 - relevant RMS personnel involved in the development of, and decision to adopt, the SMC model for Sydney region south and west zones
 - relevant RMS personnel involved in developing and managing the SMC for the Sydney region south and west zones
 - relevant Sydney region south and west zones contractor personnel involved in managing the SMC.

2. Examining

- relevant documentation which outlines RMS' justification for adopting the SMC model for Sydney region south and west zones
- RMS' rationale used to develop performance indicators and incentives incorporated in the SMC
- RMS documentation, including procedures, for managing the SMC contractor's performance
- RMS reports on the SMC contractor performance
- the RMS business case, and related documents (including Cabinet documents) used to justify the decision to outsource road maintenance and define the costs and benefits expected.

The audit approach was complemented by quality assurance processes within the Audit Office to ensure compliance with professional standards.

Audit methodology

Our performance audit methodology is designed to satisfy Australian Audit Standards ASAE 3500 on performance auditing. The Standard requires the audit team to comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance and draw a conclusion on the audit objective. Our processes have also been designed to comply with the auditing requirements specified in the *Public Finance and Audit Act 1983*.

Acknowledgements

We gratefully acknowledge the cooperation and assistance provided by staff from Roads and Maritime Services, the south and west zone contractors and other people interviewed as part of the audit.

Audit team

Ed Shestovsky conducted the audit. Giulia Vitetta and Kathrina Lo provided direction and quality assurance.

Audit cost

Including staff costs, travel and overheads, the estimated cost of the audit is \$180,000.

Performance auditing

What are performance audits?

Performance audits determine whether an agency is carrying out its activities effectively, and doing so economically and efficiently and in compliance with all relevant laws.

The activities examined by a performance audit may include a government program, all or part of a government agency or consider particular issues which affect the whole public sector. They cannot question the merits of government policy objectives.

The Auditor-General's mandate to undertake performance audits is set out in the *Public Finance and Audit Act 1983*.

Why do we conduct performance audits?

Performance audits provide independent assurance to parliament and the public.

Through their recommendations, performance audits seek to improve the efficiency and effectiveness of government agencies so that the community receives value for money from government services.

Performance audits also focus on assisting accountability processes by holding managers to account for agency performance.

Performance audits are selected at the discretion of the Auditor-General who seeks input from parliamentarians, the public, agencies and Audit Office research.

What happens during the phases of a performance audit?

Performance audits have three key phases: planning, fieldwork and report writing. They can take up to nine months to complete, depending on the audit's scope.

During the planning phase the audit team develops an understanding of agency activities and defines the objective and scope of the audit.

The planning phase also identifies the audit criteria. These are standards of performance against which the agency or program activities are assessed. Criteria may be based on best practice, government targets, benchmarks or published guidelines.

At the completion of fieldwork the audit team meets with agency management to discuss all significant matters arising out of the audit. Following this, a draft performance audit report is prepared.

The audit team then meets with agency management to check that facts presented in the draft report are accurate and that recommendations are practical and appropriate.

A final report is then provided to the CEO for comment. The relevant minister and the Treasurer are also provided with a copy of the final report. The report tabled in parliament includes a response from the CEO on the report's conclusion and recommendations. In multiple agency performance audits there may be responses from more than one agency or from a nominated coordinating agency.

Do we check to see if recommendations have been implemented?

Following the tabling of the report in parliament, agencies are requested to advise the Audit Office on action taken, or proposed, against each of the report's recommendations. It is usual for agency audit committees to monitor progress with the implementation of recommendations.

In addition, it is the practice of Parliament's Public Accounts Committee (PAC) to conduct reviews or hold inquiries into matters raised in performance audit reports. The reviews and inquiries are usually held 12 months after the report is tabled. These reports are available on the parliamentary website.

Who audits the auditors?

Our performance audits are subject to internal and external quality reviews against relevant Australian and international standards.

Internal quality control review of each audit ensures compliance with Australian assurance standards. Periodic review by other Audit Offices tests our activities against best practice.

The PAC is also responsible for overseeing the performance of the Audit Office and conducts a review of our operations every four years. The review's report is tabled in parliament and available on its website.

Who pays for performance audits?

No fee is charged for performance audits. Our performance audit services are funded by the NSW Parliament.

Further information and copies of reports

For further information, including copies of performance audit reports and a list of audits currently in progress, please see our website www.audit.nsw.gov.au or contact us on 9275 7100.

Our vision

Making a difference through audit excellence.

Our mission

To help parliament hold government accountable for its use of public resources.

Our values

Purpose – we have an impact, are accountable, and work as a team.

People – we trust and respect others and have a balanced approach to work.

Professionalism – we are recognised for our independence and integrity and the value we deliver.

Professional people with purpose

Making a difference through audit excellence.

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