

Cynulliad Cenedlaethol Cymru
National Assembly for Wales

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Chair – Audit Committee
National Assembly for Wales
National Assembly Building
Cardiff Bay,
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Sir Jon Shortridge KCB
Ysgrifennydd Parhaol
Permanent Secretary

14 APR 2004

2 April 2004

Dear Janet

**MERLIN: ADDRESSING THE AUDIT COMMITTEE FINDINGS
OSIRIS: The PFI contract for information technology in the National
Assembly for Wales (Report 02-03 Presented 25 February 2003)**

You may recall that it was agreed that I would provide a commentary on how the MERLIN contract addresses the recommendations contained in the Committee's report on the OSIRIS contract.

I have attached as an Annex to this letter a summary of how each of the recommendations has been addressed both during the contractual negotiations and in the contract awarded to the Siemens Alliance.

I can confirm that the identified lessons learned from the OSIRIS contract were paramount in determining our requirements for MERLIN and influenced the way in which the negotiations were conducted. I am reassured that the reduction in the cost of the core Information and Communication Technology solutions has allowed for the additional services supporting business change to be delivered within the envelope of current budgets. The contract also provides for improved value assurance provisions over the life of the contract.

The Alliance is a consortium led by Siemens Business Services and supported by Siemens Communications, PA Consulting and Cap Gemini Ernst & Young) that will provide the range of services supporting the business requirements.

I am sending a copy of this letter to Sir John Bourn.

*Yours sincerely
Jon Shortridge*

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COMMENTARY ON HOW THE MERLIN CONTRACT ADDRESSES THE OSIRIS AUDIT COMMITTEE RECOMMENDATIONS

NOTE: The following table includes verbatim the recommendations made by the Wales Audit Committee arising from the Auditor General Wales Report on OSIRIS. The references to the Master Services Agreement and Schedules are to the relevant parts of the new Merlin Contract.

i)	<i>Assembly officials use robust scenario planning and sensitivity analysis when letting major contracts, based on the widest possible range of eventualities and possible future political developments. Decision - making should be based both on the likelihood of such eventualities materialising, and their potential impact.</i>
	The MERLIN contract is designed to be as flexible as possible with, on the one hand, a minimum committed spend (to cover core ICT, business change and programme management services) and on the other, the capability to extend the services to other parts of the public sector in Wales should the need arise. Organisational re-structuring, take-on of new functions, different internal changes to responsibilities/processes and greater or lesser UK delegated powers have all been used to inform the shape and content of the Agreement. Price banding relating to user numbers is a feature within the cost and pricing models. Sensitivity analysis and risk assessment were embedded in the evaluation process at the Best and Final Offer review and as part of the Full Business Case. As part of the sensitivity analysis the effect of changes in user numbers and the mix of hardware solutions were also reviewed. Internal commercial financial modelling skills were used to ensure the analysis is comprehensive and accurate. Also, the contract includes mechanisms for tracking prices relative to the market to ensure that overall, regardless of changes to user numbers, processes etc the prices charged are in line with market trends. (Schedules 13, 14)
ii)	<i>Future contracts include mechanisms such as discounts or charge banding to protect the Assembly against unlimited exposure to risks.</i>
	The contract provides for volume discounts and charge banding for consultancy services (on discounted rate cards) whilst the ICT charges are structured in a manner that will produce comparative savings for changes in user numbers. A preference for unit charges per device was identified and the negotiations have given access to the

pricing model, which included visibility of supplier fixed and variable costs to ensure that economies of scale are passed on. NAW staff will be trained in the use the Pricing Model (this is the main vehicle for the production of invoices on services delivered) and contains all the base information such as day rates, ICT costs etc. This will be lodged in the Assembly's Commercial and Contracts Unit. In addition staff will in time be trained in the use of the Project Estimating model. This will initially be a generic model which, over time, using information from NAW projects / experience under MERLIN will be developed into a NAW focussed model.
(Schedule 13)

iii) *Future contracts allow greater transparency about profits made by the private sector and include clear profit sharing arrangements.*

The contract includes provisions for "open book" accountability with audit access where required (e.g. by our Internal Audit, NAO). Pricing and estimating models have been baselined as part of the contract and suitable future indexation mechanisms(RPIX) to track and keep prices in line with the overall market have also been agreed. Cost transparency will offer some assurance about profit levels, but this will be supplemented by independent benchmarking of ICT services, the right to "market test" certain services (particularly projects) and our ability to terminate the contract if necessary. Within the Project Services arrangements there are provisions to share profits on projects delivered early/under budget (and a corresponding provision to a reduced profit level on a cost overrun) (Schedules 10, 20, 14, 20 & Master Services Agreement).

iv) *Assembly officials and their professional advisers take great care to ensure that all of the terms of supplier's best and final offer are fully reflected in the eventual contract.*

The Procurement was run under EU negotiated procedures with both shortlisted suppliers through to Best and Final Offer (BAFO) ie we did not employ preferred bidder status at any time. There were no negotiations post BAFO and the structure and content of the deal (apart from final pricing) was finalised as part of detail negotiations prior to BAFO. This meant that the content of the main contract (Master Services Agreement) and the supporting schedules were all agreed and documented prior to BAFO. The final stage of this process was led by our legal team (Morgan

Cole) supported by our external advisors and Assembly Negotiation Team to keep full control of contractual documentation to reflect the negotiated position with both suppliers. Both contracts (for the two shortlisted suppliers) were negotiated against the Assembly's Terms and Conditions. (See full contractual documentation)

v) *Future contracts contain robust value for money mechanisms to enable costs to be benchmarked and externally validated. These mechanisms should extend to contractual change provisions. We also recommend that, whilst recognising the importance of affordability, value for money should always be given weight when negotiating contracts*

Value for money and value over the life of the contract is central to the MERLIN agreement. This is achieved through a variety of mechanisms including cost transparency of fixed and variable costs, independent benchmarking of all components of the ICT service, market testing of selected projects, the employment of indexation mechanisms against required day rates and ICT services, and payment by results linked to the quality of deliverables and/or time/budget. Benchmarking findings feed into price and service review points with pre-agreed mechanisms to deal with the findings and consequences and even through to right of termination as a last resort. NAW appointed auditors will also have right of access to supplier accounts, pricing and estimating models. (Schedule 14 contains the detail of these mechanisms)

vi) *The Assembly takes steps to improve accountability for expenditure on Osiris and its successor contract, ideally through delegation, so that responsibility for staff recruitment within the Assembly take account of the total employment-related costs including the information technology overhead.*

The Charges schedule allows for true costs to be invoiced to business units, supported by an agreed breakdown of information and the provision of appropriate management reports. The processes and procedures to allow for this are being developed internally and will be in place at the start of MERLIN ICT service delivery in May 2004. The Commercial and Contract Unit (which sits alongside the joint supplier/Assembly activity) is currently being set up, and will oversee these operations. Separately outside of MERLIN, procedures have been introduced that ensure all costs including the information

technology cost overheads are included for new staff appointments.
(Schedule 13 & Schedule 19)

vii) *The Merlin contract contains a break clause under which the service credit regime is reviewed after each technology refresh.*

The Assembly has negotiated a flexible arrangement whereby technology refresh will be taken forward as a business change project, supported by a business case. This will take account of the age of current hardware/software, current developments in the market, costs of continued support of existing equipment, timing and content of the business change plan. This will allow for a more considered investment decision to be taken rather than the more restrictive traditional fixed refresh cycles for hardware/software in which technology costs are based on current year charges. This arrangement allows the Assembly to have control of the rate and timing of any refresh. Therefore there is no provision for review of service credit regime on a fixed or aligned cycle required. A number of service review provisions are contracted for which allow for suitable break-points within the contract. This element also feeds into a new element of the contract to measure overall supplier performance through a "Relationship Status Index" which is fully described in Schedule 6.
(Schedules 3, 4, 6, 13, 14, 16, 17, and 32)

viii) *The improvement of the speed with which remote users can access the Assembly network be a key priority of the Merlin procurement.*

A comprehensive set of user requirements was included in the MERLIN Authority Requirements Schedule for all aspects of the service. During negotiations, specific attention was drawn to the issue of speed of access from AM constituency offices and suitable solutions identified (the present lack of availability of Broadband to all Constituency Offices prevent a single solution set). The solutions will be tested during the first six months following contract award and new solutions rolled out to constituency offices during the 2004 summer recess. (Schedule 3 and 4.)

ix) *The Assembly takes steps to minimise the delay in addressing service requests, considering carefully the likely demand under Merlin and the appropriate regime to incentivise their early resolution.*

The Main Agreement and Schedules provide for both improved ways of working and improved service levels on those provided by OSIRIS for the completion of service requests. A whole range of service levels have been agreed (linked to the service credit regime) a number of which deliver improved levels of service compared to OSIRIS. Also, these service levels will be clearly published to all users so that they are fully aware of agreed targets of performance. In addition, supplier performance in meeting service requests are one of the service level measures which feed into the Relationship Status Index (RSI), this is a mechanism which gives incentives for good performance(Schedule 3, 4 and 6)

x) *The Assembly rigorously analyses the costs and benefits of the various options available to fund the Merlin contract, ensuring that there is a clear value for money justification for the eventual decision.*

The procurement was promulgated against an expenditure envelope over the life of the contract, this envelope was based on the current charges for OSIRIS, Telephony, Maintenance & Licences and central Project Spend. In MERLIN the aim was for long-term business relationship with a single partner for an ambitious but controlled programme of business change projects. It also aimed to release sufficient funding within the existing envelope to fund new services and business change. In addition to the 'envelope' it was recognised that additional monies may become available from other Programme budgets for additional work that is within the capability of MERLIN e.g. technology support to the New Building project. The negotiation approach was successful in delivering a value for money solution with reduced cost of the core ICT services by approx. 50% thus releasing funds for the operation of the Business Development Unit, Programme Management Office and the provision of funding to deliver business change projects at no extra cost to the Assembly. At BAFO the submission was rigorously evaluated looking at the Total Cost of Ownership and the potential support for business change from release of funds. BAFO also looked at ongoing contractual value for money provisions (such as benchmarking, project services funding, RSI etc). Looking forward, the processes and procedures within the BDU will require projects, on a case by case basis, to have an approved business case which will identify funding routes, priority and closely examine the cost benefit justification prior to authorisation. (Schedules 5,6, 10, 13, 14)

xi) The effective operational relationship between the Assembly and the contractor is maintained under Merlin, and is enhanced by a more effective strategic partnership.

The MERLIN contract is predicated upon a longer term strategic relationship and this is reflected in the contractual governance arrangements and in the construction of the Relationship Status Index (RSI). Within the Governance arrangements the MERLIN Partnership and the Merlin Management Boards will oversee the partnership. The RSI whilst providing incentives for the Alliance is also designed to encourage them to treat NAW as a core, highly valued customer. In addition, it has been agreed that a Joint Relationship Charter be developed that sets down the style, behaviour and values of the partnership as a way of day to day working without the need to invoke the more formal dispute resolution processes in difficult times. (Schedule 2 and 6)

xii) The Merlin contract develops more differentiated services to meet the needs of individual users, and explores means of harnessing the views of these users more fully within the partnership in order to deliver a product that better meets their needs.

A much wider range of ICT services is available under the new contract. These reflect differentiated user requirements but are driven at all times by the business requirement as articulated by the MERLIN Partnership Board who are accountable to the NAW Executive Board. The establishment of the Business Development Unit is key in providing the processes and mechanisms whereby staff at all levels and location are able to input to the identification and development of new ideas. This will also provide the opportunity to be involved directly in projects and/or possible piloting of new innovative solutions. (Schedules 2, 3, 4, 5, 10 and 11.)

xiii) A process of regular evaluation and review be built into the Assembly's contract management arrangements from the outset of the Merlin contract.

The success of the contract and the relationship will be kept under constant review at operational and strategic levels. Appropriate measures have been identified and performance will be jointly monitored on a monthly, quarterly and annual basis. This will largely be driven by the results of the Relationship Status Index and Value Assurance mechanisms described earlier which are geared to ensuring that value for money is maintained over the

life of the contract.

Individual projects will be reviewed throughout their life-cycle and will be subject to business cycle acceptance procedures that will reward early or lower cost delivery. The over-arching mechanism for checking project outcomes will be a detailed Benefits Realisation Approach to be defined and signed off during mobilisation for MERLIN. (Schedule 14, 17 and 32)

xiv) The Assembly uses open book accounting fully within the Merlin contract, linked to mechanisms for profit sharing. We view open book accounting linked with mechanisms for profit sharing as the key means of securing a good deal from PFI contracts.

Under Merlin a basket of charging options has been established which incorporates risk and reward mechanisms that include a “never exceed” price for projects, a basket of charging options, and shared incentives where a project delivers ahead of time or at reduced cost. A proportion of the work of the Business Development Unit will be funded from successful outcomes and supplier rewards (e.g. guaranteed business opportunities) will be earned by exceeding customer expectations. Core supplier resources will flex according to demand. Market testing of selected services and benchmarking will feature as required. Taken together, the charging and incentivisation within MERLIN will ensure that value is obtained not only at the outset, but throughout the life of the contract. This will be supplemented by open book accounting at least to a level typically achieved across government and, because of NAW access to supplier estimating models, with potentially greater transparency. The visibility of ICT pricing inc variable/fixed costs alongside value assurance mechanisms will help in ensuring that profit levels are kept in line with negotiated position.

MERLIN is not a PFI contract. (Schedule 13, 14, 11, 20)

MERLIN – SRO’S REPORT ON ACTION TAKEN TO ADDRESS THE MAIN IDENTIFIED CAUSES OF PROJECT FAILURE

Risk of Failure		Risk / issue Description	Risk log
<p>1. Lack of a clear link between the project and the organisation’s key strategic priorities including agreed measures of success.</p>		<p><i>Strategic and contract Risks</i></p> <p>The Executive Board agreed at a very early stage the nature of the business problem MERLIN was designed to address and how it fitted with other priorities and initiatives by the Executive Board. The Board gave deep consideration to the nature and scope of the new contract during several away sessions and workshops.</p> <p>A market sounding exercise was conducted prior to identifying overall requirements. During the course of the procurement a “study period” was held with shortlisted suppliers. The study period included senior level presentations by the suppliers. These gave the Executive Board an opportunity to challenge the suppliers understanding of the strategic aims and confirm the Board’s thinking on the nature and scope of the contract they were seeking. This consideration was aligned to the Executives Board’s own vision and strategy for change and Ministers’ strategic policy programme. The subsequent detailed contract requirements were developed out of the study period as a basis for negotiation with suppliers.</p> <p><i>Procurement Programme and project risks</i></p> <p>To provide greater assurance that the options for priorities and</p>	<p>82</p> <p>89</p> <p>26</p>

	<p>processes within the Merlin change programme were consistent with the strategic objectives - a project was set up specifically to define the nature of the business change agenda within the MERLIN Procurement Programme. This involved a considerable input from the business and Executive Board in confirming the direction that was being developed for inclusion in the contract.</p> <p>To safeguard against poor measures of success within the procurement programme, criteria were specified as part of the Programme Definition Document. This was a key input to defining the component projects, deliverables and plans within the programme.</p> <p>Risk sharing and incentivisation options were a key feature throughout negotiations with suppliers and were addressed in a number of areas in the contract. Projects will be developed and approved on a case by case basis and will be subjected to stringent quality checks and an innovative risk/reward mechanism. In addition a risk/reward payment mechanism has been agreed to incentivise the actual delivery of a project to time and budget.</p> <p>To recognise and understand success within each project, every project in the Procurement programme, including the main Procurement Project, had a documented PID and supporting Project Board that signed off all key deliverables. All Project Boards were very active in ensuring products were fit for purpose and subject to detail scrutiny.</p>	<p>154</p> <p>177</p>
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2. Lack of a clear senior management and Ministerial ownership and leadership		<i>Strategic and Contract Risks</i>	28
		The Executive Board’s Management Plan provided a key link to establishing a set of common requirements. Throughout the procurement, there was regular dialogue between senior Assembly management and ministers. In addition, a sub-group of the Executive Board, chaired by the Permanent Secretary, was set up specifically to provide guidance and act as a point of escalation for the Procurement Project on any major strategic/contractual issues.	29
			50
			53
			97
		Progress against plans and outcomes of any key procurement issues were discussed with both ministers and the Executive Board sub-group and full support given to the Procurement Team.	105
		<i>Procurement Programme and Project Risks</i>	137
		A project board led the Procurement Project with members drawn from senior management within the Assembly and two non-executive members who brought significant experience of major contract procurement. The board was actively engaged with the project and acted in a robust and serious capacity in approving plans, signing off key deliverables, dealing with major risks/issues and giving guidance to the procurement team. This also included input from other projects in the programme that impacted on procurement decisions.	
		A separate project was also established to support specific requirements of the Assembly Members and Presiding Office to ensure that their needs were taken into account in the overall requirements. A senior manager in the Presiding Office led this project with inputs from Assembly Members and their staff.	

		A Programme Board was set up to provide overall governance of the projects within the programme and ensure that any key interdependencies were managed.	
3. Lack of effective engagement with stakeholders.		<p><i>Strategic and Contract Risks</i></p> <p>At an early stage of the programme, a full stakeholder’s analysis was carried out to ensure that all interested parties were covered. From this, a more detailed Communications Strategy and Plan were then developed. The plan was used as a basis for communicating key messages throughout the procurement to all interested parties.</p> <p>In addition, senior Assembly management met with ministers on a regular basis to keep them informed of progress, key decisions and major issues. The Executive Board sub-group were also fully engaged with any major decisions and/or issues.</p> <p>Project Boards were established for each project specifically to provide effective governance over the delivery of the project but also to ensure that any key messages were conveyed to all interested parties.</p> <p>A series of face to face briefings of Assembly staff was also conducted as part of Divisional Away Days during the latter part of 2003.</p> <p><i>Procurement Programme and Project Risks</i></p> <p>Each project team was responsible for producing regular progress reports that were used to share information across projects, provide</p>	<p>100</p> <p>115</p> <p>122</p> <p>140</p> <p>175</p> <p>188</p> <p>220</p>

	<p>key information to senior Assembly management and ministers. This was supported by weekly face to face meetings with project managers to ensure that any key interdependencies or issues were actioned. Everyone involved was kept up to date with current developments. This extended to reports from the Legal Team on contractual drafting progress.</p>	
<p>4. Lack of skills and proven approach to project management and risk management.</p>	<p><i>Procurement Programme and Project Risks</i></p> <p>As part of setting up the programme and projects, best practice was adopted from OGC Guidelines on running successful programmes, adoption of PRINCE 2 methodology for projects and OGC approach to risk management.</p> <p>A Risk Manager was appointed (an OGC Consultant was used who was part of the programme team) to establish to required processes and practices.</p> <p>All project managers and teams have enhanced their skills and experience of operating in this environment which will be carried forward into the MERLIN partnership.</p> <p>Appointment of experienced Programme Manager and Risk Manager provided the necessary guidance, discipline and support to projects to deliver against particularly stretching targets.</p> <p>All project managers were trained in the PRINCE 2 methodology.</p> <p>Formal risk/issue registers were established for projects and the</p>	<p>85</p> <p>86</p> <p>87</p> <p>161</p>

		programme and regularly reviewed at board meetings.	
5. Lack of understanding of and contact with supply industry at senior levels in the organisation		<p><i>Strategic and Contract Risks</i></p> <p>Prior to commencement of the procurement process, a market sounding exercise was conducted to test out the proposed scope and approach with potential suppliers. Subsequently, as the procurement progressed, a number of workshops and presentations with suppliers were held to ensure alignment on requirements, scope and style of relationship. The latter was a particularly key element for both senior supplier and Assembly management as the basis of the new contractual arrangements was to establish a partnership with the selected supplier. These sessions helped to inform the more detail requirements around the nature of the partnership being sought and what governance arrangements would be needed.</p> <p><i>Procurement Programme and Project Risks</i></p> <p>Through workshops, presentations and negotiations, there was considerable contact between suppliers and senior management particularly around partnership and governance arrangements. This resulted in the inclusion of a relationship charter within the contract, the establishment of joint management/partnership boards and membership from the Assembly on the Alliance Board. This will enable the appropriate contact to be maintained throughout the life of the contract.</p>	81

<p>6. Evaluation of proposals driven by initial price rather than long-term value for money (especially securing delivery of business benefits).</p>		<p><i>Strategic and Contract Risks</i></p> <p>Negotiations were fully driven by overall value for money. Clearly price was a key component of the deal and a reduction of 55% was achieved on current ICT costs. This is in line with market conditions including the building in of innovative value for money mechanisms to protect the Assembly over the life of the contract and are contained in a specific schedule of the contract. Also, full visibility was given to the total cost of ownership across all aspects of the deal including innovative risk reward mechanisms. This was also measured not just in financial terms but also across 23 order winning criteria.</p> <p>The area around business benefits has been secured through risk/reward mechanisms associated with the delivery of quality business cases and subsequent delivery of projects.</p> <p><i>Procurement Programme and Project Risks</i></p> <p>Negotiations were driven entirely by the Assembly’s requirements and at the end of the process, two acceptable contracts had been submitted. These included, in both cases, a value for money proposition with one supplier clearly better than the other.</p>	<p>40</p> <p>72</p> <p>76</p> <p>108</p> <p>155</p>
<p>7. Development and implementation not split into manageable steps i.e. “big bang” approach adopted</p>		<p><i>Strategic and Contract Risks</i></p> <p>Key to successful delivery is the approach to a joint mobilisation phase with the supplier during the first six months of the contract. This will ensure that all aspects of the partnership are given high visibility</p>	<p>98</p> <p>252</p>

	<p>and are robust before getting into the serious delivery of business change. This includes the successful transition of existing ICT services and the development of a joint change plan.</p> <p>The change plan itself will then be delivered by a portfolio of individual projects, approved on a case by case basis and managed through a programme management office. In this way, change will be delivered in a structured and phased way with no “big-bang” implementations.</p> <p><i>Procurement Programme and Project Risks</i></p> <p>In readiness for implementation within the contract detail plans, schedules and project initiation documents were submitted by each supplier during the final stages of negotiation to ensure that the approach referred to above was carried through into live operation of the contract. This was managed at a detailed level with both suppliers to define their approach including payment mechanisms that rewarded quality and success.</p>	
8. Inadequate resources and skills to deliver the total portfolio.	<p><i>Strategic and Contract Risks</i></p> <p>This was and still is a major area of activity. Alongside the procurement process, work has been carried out to design a new structure to support the partnership nature of the contract. An Appointments process is well underway to move existing staff into a new role by end of April. Work is also in hand to develop resource management processes that will be required to support the delivery of the change plan – typically project management resources/skills</p>	<p>44</p> <p>47</p> <p>57</p> <p>90</p> <p>94</p>

	<p>In addition, as part of the new structure, a Commercial and Contracts Unit will be set up specifically to manage contractual and compliance issues on behalf of the Assembly.</p> <p><i>Procurement Programme and Project Risks</i></p> <p>Within the programme and supporting projects, use was made of existing staff to project manage the various projects. The SRO was OGC MSP practitioner trained. All project managers were PRINCE trained and supported by an experienced programme manager. Best practice processes were also deployed across the programme.</p>	<p>113</p> <p>165</p>
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