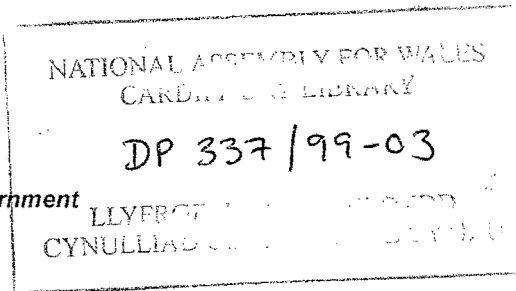


Edwina Hart AM MBE
Minister for Finance, Local Government
and Communities



Llywodraeth Cynulliad Cymru
Welsh Assembly Government

Our ref: SF/EH/0336/03

Dafydd Wigley AM
Chair, Audit Committee
National Assembly for Wales
Cardiff Bay
Cardiff
CF99 1NA

3 April 2003

Dear Dafydd

**Welsh Assembly Government Response To The Audit Committee Report
"OSIRIS: The PFI Contract for Information Technology in the National
Assembly for Wales"**

On 25th February you presented the above report to the National Assembly for Wales under section 102(1) of the Government of Wales Act 1998.

I enclose the Assembly Government's response to the recommendations made in the report. This response will be laid before the Assembly in accordance with Standing Order 12.5.

The thrust of the reply is that the recommendations of your Committee will in the main be taken up in the MERLIN Programme. Where this is the case then the actions will in general be complete when the MERLIN contract goes live and that is scheduled for January 2004. The exceptions to this date are for recommendation vi) when the agreed action happened in November 2002 and recommendations v), xiii) and xiv) where the agreed action continues throughout the period of the MERLIN contract.

On behalf of the Assembly Cabinet, I would like to thank you and the Committee for the careful and considered way in which you undertook the investigation and produced this report.

Edwin



BUDDSODDWR MEWN POBL
INVESTOR IN PEOPLE

Dafydd Wigley AM
Chair, Audit Committee
National Assembly for Wales
Cardiff Bay
Cardiff

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On behalf of the Assembly Cabinet, I would like to thank you and the Committee for the careful and considered way in which you undertook the investigation and produced this report.

Welsh Assembly Government Response To The Audit Committee Report “OSIRIS: The PFI Contract for Information Technology in the National Assembly for Wales”

The Welsh Assembly Government is grateful for the report. We welcome the findings and offer the following response to the fourteen recommendations in the Report.

Recommendation 1: 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.

Agreed - a robust scenario planning, risk and sensitivity analysis will be included in the Full Business Case for MERLIN. The Full Business Case will be completed in July 2003.

In respect of this and the other recommendations made by the Committee with regard to major contracts in the future: the Assembly Compliance Office will circulate, before the end of April 2003, the Committee's recommendations and a copy of this response both within the Assembly and to Assembly Sponsored Bodies for their attention.

Recommendation 2: Future contracts include mechanisms such as discounts or charge banding to protect the Assembly against unlimited exposure to risks.

Agreed for Information and Communications Technology contracts - a range of mechanisms to reduce exposure to risk including discounts, charge banding, possibly shared benefits etc. will be included in the MERLIN contract.

Recommendation 3: Future contracts allow greater transparency about profits made by the private sector and include clear profit sharing arrangements.

Agreed for Information and Communications Technology contracts - open book accounting will be integral to the MERLIN contract. The MERLIN contract will be modelled on the best practice guidance from the Office of Government Commerce including a cap on profits and profit sharing arrangements. Performance related payments will also form part of the payment arrangements. The potential MERLIN suppliers have been informed that in addition to the above it is likely that a range of charging arrangements will apply for different elements of the contract .

Recommendation 4: Assembly officials and their professional advisers take great care to ensure that all of the terms of suppliers' best and final offer are fully reflected in the eventual contract.

Agreed – the Best and Final Offer from the successful MERLIN supplier will become an integral part of the MERLIN contract.

Recommendation 5: 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.

Agreed - a rigorous value testing regime capable of external validation will be included in the MERLIN contract. Delivery of benefits from the MERLIN Change programme will be continuously monitored. Achieving good value for money is a fundamental objective of the MERLIN negotiations; and more widely, of contract management and procurement procedures within the Assembly.

Recommendation 6: 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.

Agreed – since November 2002 new IT equipment is only being supplied under the OSIRIS contract if the requesting business area can demonstrate a sound business case acceptable to Business Information Systems Division.

In the case of recruitment to fill vacancies from April 2003 the business area must demonstrate that their allocation of Departmental Running Costs (DRC) cover any additional costs arising from the provision of IT and this will be used to fund the expenditure. This regime will also apply to casuals recruited to carry out non permanent tasks, or secondments into the Assembly, or the employment of contractors/consultants.

The policy decision has been taken to delegate budgets to individual business areas for both existing and new staff. The practicalities of introducing delegated budgets within a centralised contract management structure. will be examined in the discussions for the MERLIN contract. Since this will necessarily need to involve the Merlin contractor introduction of a full delegated budget system will not be possible before April 2004.

Recommendation 7: The MERLIN contract contains a break clause under which the service credit regime is reviewed after each technology refresh.

Agreed - It is intended to include break clauses related to both Time and Performance at which all aspects of the charging mechanisms will be candidates for review and change.

Recommendation 8: The improvement of the speed with which remote users can access the Assembly network be a key priority of the MERLIN procurement..

Agreed - the MERLIN Outline Statement of Requirement which was issued to potential suppliers included the need for high speed connections for constituency offices and other remote users. This has been reinforced by officials with the short listed suppliers. The potential suppliers have acknowledged they understand the imperative to resolve this as a priority as soon as the new contract takes effect.

Recommendation 9: 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.

Agreed – the potential MERLIN suppliers will be asked to encompass in their proposed solutions various options for the delivery of Service Requests more directly targeted at the differing requirements of different parts of the Assembly.

Recommendation 10: 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.

Agreed - this will be reflected in the Full Business Case

Recommendation 11: The effective operational relationship between the Assembly and the contractor is maintained under MERLIN, and is enhanced by a more effective strategic partnership.

Agreed - MERLIN will be a strategic partnership that will identify and incorporate relevant and enforceable governance arrangements.

The Permanent Secretary in his evidence to the Committee stated his intention of setting up a partnership committee under his joint chairmanship to run the implementation of the contract. The potential suppliers recognise the Permanent Secretary's intent for a partnership committee which is to form part of the governance arrangements of the MERLIN contract.

Recommendation 12: 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 which better meets their needs.

Agreed - the "one size fits all" approach has no place in the MERLIN requirement. The potential MERLIN suppliers have been asked to forward proposals for a variety of different categories of users. These will be discussed with them during the detailed contract negotiations.

The MERLIN contract will also incorporate flexibility in adapting arrangements to meet circumstances. This will include technological innovation that could not reasonably be foreseen at the outset.

Recommendation 13: A process of regular evaluation and review be built into the Assembly's contract management arrangements from the outset of the MERLIN contract.

Agreed - this will be established under the partnership and governance arrangements that will be put in place for MERLIN.

Recommendation 14: 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.

Agreed – open book accounting is an integral requirement of the MERLIN procurement process and will be included in the final contract and its management arrangements.

Philip Lunn
BIS - for your
records.

PHL:AL
27.2.03



Cynulliad Cenedlaethol Cymru
The National Assembly for Wales

Pwyllgor Archwilio/Audit Committee

Y Gwir Anrh Rhodri Morgan AC
Prif Weinidog Cymru
Cynulliad Cenedlaethol Cymru
Bae Caerdydd
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Bae Caerdydd / Cardiff Bay
Caerdydd / Cardiff
CF99 1NA

25 Chwefror 2003

Anrhydd Rhodri

**ADRODDIAD Y PWYLLGOR ARCHWILIO OSIRIS: CONTRACT PFI AR
GYFER DARPARU TECHNOLEG GWYBODAETH YNG NGHYNULLIAD
CENEDLAETHOL CYMRU**

Ysgrifennaf atoch i ddarparu copi o adroddiad y Pwyllgor Archwilio ar yr Adroddiad Osiris: Contract PFI ar gyfer technoleg gwybodaeth yng Nghynulliad Cenedlaethol Cymru yn unol â Rheol Sefydlog 12.5. Gosodwyd yr adroddiad gerbron y Cynulliad gan y pwyllgor ar 25 Chwefror 2003 yn unol ag adran 102(1) o Ddeddf Llywodraeth Cymru 1998.

Mae'r pwyllgor yn edrych ymlaen at dderbyn ymateb Llywodraeth Cynulliad Cymru i'r adroddiad.

Yr aaispwrnt
Dafydd Wigley

Dafydd Wigley
Cadeirydd y Pwyllgor Archwilio

Embargoed until 00:01am
on Tuesday 25th February 2003



Cynulliad Cenedlaethol Cymru
The National Assembly for Wales

Audit Committee

Osiris: The PFI contract for information technology in the National Assembly for Wales

Committee Report 02-03

February 2003

THE NATIONAL ASSEMBLY FOR WALES: AUDIT COMMITTEE

Report 02-03 – Presented to the National Assembly for Wales on 25th February 2003 in accordance with section 102 (1) of the Government of Wales Act 1998

Osiris: The PFI contract for information technology in the National Assembly for Wales

Contents	Page
Introduction	1
The cost of Osiris	2
Functionality and the quality of services provided	6
The Osiris PFI contract	8
Summary of recommendations	12
Concluding comments	13

ANNEXES

Annex A: Relevant proceedings of the Committee – Minutes of evidence (Thursday 21 November 2002)

Annex B – Letter from Sir Jon Shortridge to the Clerk to the Audit Committee, 20 December 2002

Annex C – The Audit Committee

Introduction

1. In this report we examine the procurement of the Osiris (Office Systems and Infrastructure Review and Infrastructure Strategy) computer system by the Welsh Office, and its subsequent extension to meet the additional needs of the National Assembly for Wales. Osiris was procured through a seven-year private finance initiative (PFI) contract with Siemens Business Services (SBS), let by the then Welsh Office in January 1997. The system provided networked office automation software throughout the Welsh Office's operations. This was the first PFI deal of its kind in the United Kingdom.
2. The onset of devolution and the transfer of functions to the National Assembly represented a unique challenge for Assembly officials; it also significantly changed and increased the organisation's information technology needs. Because of the short timescale for delivering the additional services, exacerbated by uncertainty about the location of the Assembly, the Assembly chose to extend SBS's contract to cover its additional requirements.
3. The Osiris contract is based on a monthly charge for each user logging onto the network. For a variety of reasons the number of users has risen considerably since the contract was first let. Consequently the projected lifetime cost of the Osiris contract rose from £20.9 million in October 1997 to £26.1 million prior to the transfer of functions to the Assembly. After the extension of the contract, its lifetime projected cost rose from £46.2 million to the most recent estimate of £64.4 million.
4. The Osiris contract expires in January 2004. The Assembly is currently running a competitive procurement to deliver its successor system, which is to be known as Merlin. The Merlin contract award is scheduled for July 2003, with a six-month transitional phase prior to the contract commencing in January 2004. All of the recommendations in this report aim to ensure that the Assembly learns all of the lessons from the Osiris procurement and secures a good deal from the Merlin contract.
5. On the basis of a report produced by the National Audit Office Wales on behalf of the Auditor General for Wales¹, we took evidence from Sir Jon Shortridge, Permanent Secretary, supported by Mr David Richards, Principal Finance Officer, Mr Nigel Finlayson, Head of Business and Information Systems Division, and Mr Bryan Mitchell, Head of Business and

¹ Report by the Auditor General for Wales, *Osiris: the PFI contract for information technology in the National Assembly for Wales*, presented to the National Assembly for Wales on 18 October 2002.

Information Management Directorate. This report considers the cost of the Osiris contract, functionality and the quality of services provided, and the PFI contract and its management.

The cost of Osiris

User numbers

6. Since the key driver of costs under the Osiris contract is user numbers, this represented the major risk to the Assembly. Substantial increases in user numbers compared with forecasts would penalise the Welsh Office/Assembly, while reductions would disadvantage SBS. However, forecasts of demand for services under Osiris were consistently inaccurate throughout the life of the contract. For example, at the time the contract was first let, the maximum number of users expected in the Welsh Office's sensitivity analysis on user numbers was 1,875. However, by March 1999 user numbers had reached 2,361.² The Permanent Secretary told us that early forecasts of user numbers were predicated on a general expectation that the size of the Welsh Office would reduce.³ We are particularly concerned that the investment appraisal did not appear to have considered possible wider political developments, such as devolution, which was the stated policy of the major opposition party at the time when the Osiris contract was let.⁴ We recognise the sensitivities involved in such matters but, as events proved to show, when letting long-term contracts such as this it is essential to take all relevant factors into account.
7. When it came to extending the contract to meet the needs of the new National Assembly, officials were faced with considerable – and understandable - difficulties in forecasting user numbers.⁵ The contract extension was negotiated on the basis of a forecast maximum number of 2,875 users up to April 2002, after which numbers would reduce by 5 per cent a year. But, by September 2002, user numbers had reached 4,062.⁶ The inaccuracy of Assembly officials' forecasts of user numbers was the principal reason for the 39 per cent increase of Osiris costs beyond those forecast at the time the contract was extended. The Permanent Secretary commented that the primary focus of the re negotiation was compliance with European

² AGW Report, paragraphs 2.15, 2.19 and 2.21

³ Qs 15-19

⁴ Qs 3-5

⁵ Q111; AGW Report, paragraph 3.25

⁶ AGW Report, paragraph 3.23

procurement regulations.⁷ While we recognise the need for such compliance, in our opinion the Assembly should have sought to recognise the possibility of even greater user numbers.

8. During the negotiations to extend the Osiris contract, Assembly officials used sensitivity analysis to examine profit levels, but not the key cost driver - user numbers. This was despite the fact that user numbers had already risen considerably above the levels forecast even before devolution.⁸ The use of sensitivity analysis on user numbers would have exposed the potential impact of an increase in user numbers,⁹ and its omission when the contract was extended is regrettable. **We recommend that 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 financial impact.**
9. Such use of sensitivity analysis may have encouraged officials to negotiate mechanisms in the contract, such as a sliding set of charges based on volume discounts, to protect the Assembly against full exposure to the risk of user numbers rising.¹⁰ The Permanent Secretary told us that such mechanisms were not included because he believed that they would constitute a material change in the basis of the contract.¹¹ In the apparent absence of any legal advice on the specific issue of including such mechanisms in the contract, we are not persuaded by the argument that amending the pricing mechanism in this way would represent a material change to the contract. In the context of the forthcoming Merlin contract **we recommend that future contracts include appropriate mechanisms to protect the Assembly against unlimited exposure to key risks.**

SBS's profit margin

10. SBS based their charges for the extended contract on the Assembly's estimate of 2,875 users. The subsequent rise to 4,062 users has enabled SBS to increase its profit margin.¹² Witnesses told us that the Assembly's estimate of the financial return to SBS from the Osiris contract, over the life of that contract to January 2004, was consistent with market norms for contracts

⁷ Qs 113-114

⁸ AGW Report, paragraph 3.26; Q117

⁹ AGW Report, paragraph 3.27

¹⁰ AGW Report, paragraph 3.27

¹¹ Qs 115-117

¹² AGW Report, paragraph 3.35

of this type - within the range of 10 to 15 per cent.¹³ Profit-sharing arrangements are a common feature of more modern PFI contracts – one of the mechanisms for reducing risk, set out in the previous paragraph – and would have enabled both partners to share in the unexpected increase in profit obtained through this contract.

11. The Permanent Secretary told the Committee that he could not provide detailed information about the Assembly's assessment of SBS's likely profits because of commercial confidentiality arising from the ongoing Merlin procurement.¹⁴ Needless to say, the Committee would never put itself in the position of potentially jeopardising the Assembly's ability to negotiate the best possible deal on a future contract. Nevertheless, this instance illustrates an important point of principle, that to the maximum extent possible, relevant figures should be open to public scrutiny. We therefore welcome the Permanent Secretary's full agreement with that principle.¹⁵ Subsequent to our meeting, the Auditor General has provided further information on SBS's profits in confidence to the Chair of the Committee. **We recommend that future contracts allow for greater transparency about profits made by the private sector and include clear profit sharing arrangements.**

The extension of SBS's contract

12. Even allowing for the early rise in user numbers, the original contract represented a good deal for the Welsh Office. The advent of devolution was a unique challenge. We accept that, in the very difficult circumstances in which they were operating, the Assembly had little option other than to obtain the additional services by extending SBS's existing contract, and that in order to deliver the services in time for the opening of the Assembly, SBS had to start work before the price of services had been agreed.¹⁶ This strengthened SBS's negotiating position and led to a situation which the Permanent Secretary described as "a quite searing experience".¹⁷
13. In this context we commend officials for negotiating a 34 per cent reduction in the cost of the additional services, from SBS's initial offer of £29 million to £19.2 million, while ensuring that the additional services were delivered in time for the opening of the Assembly.¹⁸

¹³ Qs 135-136

¹⁴ Q144

¹⁵ Q146

¹⁶ AGW Report, paragraphs 3.4 to 3.6 and Figure 7

¹⁷ Qs 77-78

¹⁸ AGW Report, paragraphs 3.14 and 3.20

Witnesses repeatedly described this achievement as the best outcome they could have achieved.¹⁹ However, we note that the cost model for the extended contract also included several costs that had not been part of SBS's best and final offer when the contract was originally negotiated. These included items such as the cost of SBS's senior managers in their head office and the cost of staff bonuses, a higher projected profit margin and more favourable treatment of inflation.²⁰ The extended contract, although possibly the best that could be negotiated, was therefore not such a good deal for the Assembly.

14. The Auditor General also reported that the Assembly contributed £377,000 towards the price sought by SBS for technology refresh (upgrading hardware and software), an item which was included in the contract as part of the user charge. The additional payment arose from a failure to reflect fully the terms of SBS's best and final offer (allowing the Assembly to specify the timing of technology refreshment) in the actual Osiris contract.²¹ The Permanent Secretary told us that this prevented Assembly officials from insisting on the provision of technology refresh at a particular time. The operational imperative to ensure that all Osiris users were using the same operating system when the Assembly opened meant that the Assembly had little option other than to contribute to the cost of technology refresh, despite its cost forming part of the user charge.²² **We recommend that 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.**

15. The Auditor General reported that the focus of the negotiating team had been more on affordability than on value for money. The primary reason for this was the absence in the contract of mechanisms that are common to more recent contracts, such as benchmarking and compulsory market testing at the expense of the supplier.²³ Such provisions would have helped officials to assess the reasonableness of SBS's proposed charges. The only assurance the Assembly was able to obtain was a short letter from SBS's supplier indicating that costs were comparable with market norms.²⁴ The Permanent Secretary observed that the benchmarking of costs proved difficult without mandatory contractual mechanisms, although

¹⁹ Qs 64, 68 and 76

²⁰ Annex B (Letter from Sir Jon Shortridge to the Clerk to the Audit Committee, 20 December 2002); AGW Report, Figure 9

²¹ AGW Report, Figure 8

²² Qs 97-100

²³ AGW Report, paragraph 3.15

²⁴ AGW Report, Figure 9

he did state that the negotiating team sought to examine value for money issues insofar as they could.²⁵ We recommend that 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 issues should always be given weight when negotiating contracts.

16. We were concerned about the cost of the out of hours help desk for Assembly Members, reported by the Auditor General to have been effectively £6,000 per call.²⁶ The Permanent Secretary explained that this was because only two calls had been received. He added that the trial period for the service has now been terminated because of insufficient demand.²⁷

Budgetary control

17. The Auditor General reported that there was only limited control of the overall budget for Osiris. The budget has always been held centrally, meaning that recruitment activities within divisions of the Assembly could take place without considering the overhead cost that each additional user of Osiris incurred.²⁸ The Permanent Secretary confirmed in his evidence that there was room for improvement in the control of expenditure on Osiris and informed the Committee of his intention to delegate the Osiris budget to groups and divisions from April 2003.²⁹ We welcome this proposal since proper budgetary accountability is essential to improve control of expenditure in a demand-led situation such as Osiris. We recommend that the Assembly takes steps to improve accountability for expenditure on Osiris and its successor contract so that those responsible for staff recruitment within the Assembly take account of the total employment-related costs, including the information technology overhead.

Functionality and the quality of services provided

18. We join the Auditor General in commending the Welsh Office/Assembly for the rapid roll-out of the original Osiris system and for delivering the additional services under the extended

²⁵ Qs 93 and 96

²⁶ AGW Report, paragraph 3.33

²⁷ Q148

²⁸ AGW Report, paragraph 4.25

²⁹ Qs 180-181

contract in time for the opening of the National Assembly.³⁰ We are also proud of the fact that the system in the National Assembly for Wales is more advanced than that in many other Parliaments and Assemblies.³¹

19. The Committee has a direct interest in the quality of the service provided under the Osiris contract. The Auditor General found that, according to its users, the various elements of the Osiris system generally performed well.³² Network availability generally exceeded contractual targets – consequently SBS has received bonus payments in nineteen of the twenty-two quarters to date.³³ We were surprised that bonus payments had been made so regularly and pressed witnesses on this issue. They confirmed that performance improved after technology refresh but that there was no change to the performance standards expected of SBS despite the more reliable hardware and software arising from this upgrade. The Head of Business and Information Systems Division said that performance management for contracts of this type had developed considerably since the original Osiris contract.³⁴ For the Merlin procurement, **we recommend that, if appropriate, the contract contain a break clause under which the service credit regime is reviewed after each technology refresh.**
20. Although user satisfaction was generally high, the Auditor General's surveys revealed that remote users of the network – such as Assembly Members and their staff dialling into the network from homes or constituency offices – were far from satisfied with remote use because they could not use the system at an appropriate speed.³⁵ Indeed, the Permanent Secretary told us that this problem was a personal frustration of his.³⁶ The slow speed with which remote users can access Osiris relates principally to the quality of the telephonic infrastructure in Wales, and is consequently outside the scope of the Osiris contract. However, as we made clear when taking evidence from the witnesses, given that Members work away from Cardiff Bay on most Mondays and Fridays, the ability to access papers remotely is critical to providing suitable levels of service to constituents.³⁷ In response to our concerns, the Head of Business and Information Systems Division confirmed that the

³⁰ AGW Report paragraph 3.20

³¹ Q108

³² AGW Report, paragraphs 4.2 to 4.12

³³ AGW Report, paragraph 4.2

³⁴ Q163

³⁵ AGW Report, paragraph 4.4

³⁶ Q157

³⁷ Qs 158-162

Broadband Wales programme, allied to the inclusion in Merlin of an integrated voice-data solution, should lead to considerable improvements for remote users.³⁸ The Committee wishes to stress the importance of improving the speed of remote access, and **we recommend that the improvement of the speed with which remote users can access the Assembly network be a key priority of the Merlin procurement.**

21. We were interested in the recent development of the Information Technology Skills Academy and welcome its innovative approach to training, especially its ability to tailor training to individuals' particular needs.³⁹ It is notable both that this initiative came from within the Assembly, and that the contract has been sufficiently flexible to accommodate a degree of switching from conventional training to the Academy at no extra cost.⁴⁰
22. The fact that the Assembly is making additional payments to SBS to reduce the turnaround time for service requests from twenty to fifteen days was a source of some concern to us. This delay in actioning service requests arose because the Assembly significantly underestimated the demand for service requests at the time the contract extension was negotiated.⁴¹ The Head of Business and Information Systems Division reported that the turnaround time now stood at twelve days. We consider this an excessive wait and were interested to note the witnesses' comment that any delay is often the result of poor specification of requests by line managers.⁴² **We recommend that 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 Osiris PFI contract

The use of PFI and the adequacy of the contract

23. We were interested in the financial basis of the decision to employ a PFI approach rather than conventional procurement. The Auditor General reported that National Audit Office Wales staff had found no written evidence of a Public Sector Comparator showing the relative value for money of PFI compared to conventional procurement.⁴³ The Permanent Secretary has

³⁸ Qs 155-157

³⁹ AGW Report, paragraphs 4.9 to 4.10

⁴⁰ Q168

⁴¹ AGW Report, paragraphs 3.30 to 3.32

⁴² Qs 121-122 and 125-132

⁴³ AGW Report, paragraph 2.8

written to the Committee, clarifying that the use of a Public Sector Comparator was not a mandatory part of the Treasury's Green Book guidance at the time that the decision was made to proceed with PFI as the sole funding mechanism in January 1996.⁴⁴ Nonetheless, the use of a Public Sector Comparator was regarded as best practice at the time, and we are surprised that the decision was made to proceed with PFI without a thorough analysis of the business costs and benefits to confirm that PFI offered better value for money than traditional procurement. The Head of Business and Information Systems Division told us that the investment appraisal for Merlin would focus on lifetime whole costs, rather than a strict Public Sector Comparator, since the outsourcing of the provision of information technology services under Osiris made it impossible to compare the cost of direct provision.⁴⁵ **We recommend that the Assembly rigorously analyses the costs and benefits of the options for funding the Merlin contract, ensuring that there is a clear value for money justification for the eventual decision.**

24. As to whether the PFI had proved to be successful in practice, witnesses reported that the main benefit of the PFI approach had been that of earlier roll-out of the system. The original Osiris system was delivered in nine months, whereas roll-out through conventional methods would have been phased in over three to four years because of capital constraints.⁴⁶ When the contract was extended the additional services were delivered in time for the transfer of functions to the Assembly – as we have commented above, a considerable achievement. The other main benefits of the PFI approach were the transfer of risk, which took place during the early stages of the contract,⁴⁷ and the harnessing of private sector expertise to provide what witnesses, and the Auditor General's report, generally described as high quality information technology services.⁴⁸
25. Witnesses told us that the main problems with Osiris arose, not from the PFI approach in itself, but from the inflexibility and outdated nature of the contract - Osiris was the first PFI deal for an IT infrastructure in the United Kingdom.⁴⁹ Although the contract and the partnership between the Assembly and SBS were sufficiently flexible to enable the extension

⁴⁴ Annex B (Letter from Sir Jon Shortridge to the Clerk to the Audit Committee, 20 December 2002); AGW Report, paragraph 2.6

⁴⁵ Q27

⁴⁶ Q24

⁴⁷ Q8, AGW Report paragraph 2.12-2.14 and Figure 3

⁴⁸ Q157, AGW Report paragraphs 4.2-4.12

⁴⁹ Q13

of the contract to meet the additional requirements of the Assembly, the contractual terms were not sufficiently flexible in areas such as benchmarking, profit sharing and pricing. The balance between risk and reward, expressed through the payment mechanism, was crude – and, because it was not possible to link payment to core business outputs, the Osiris contract delivered little innovation.⁵⁰ Witnesses referred to the considerable development of PFI practice since this contract was let, and to guidance produced by the Office of Government Commerce, assuring the Committee that such guidance would inform all steps under the Merlin procurement should this follow a PFI route.⁵¹

26. Witnesses informed the Committee that they intended the Merlin contract to be more sophisticated, containing specific projects for business improvement where there could be an individual payment stream based on the achievement of specific business outputs.⁵² We welcome the assurance that the more flexible contract, which the Merlin procurement is designed to deliver, should provide far greater incentives for innovation.

Contract management

27. Good contract management and the development of a truly effective partnership are essential components of the most successful PFI deals. Such partnerships need to work not only on the ground but also at the top of each organisation with regular communication and contact between senior executives about opportunities to develop and improve the partnership. The Auditor General reported that the Osiris partnership worked very well at the operational level but was less effective at a strategic level.⁵³ Witnesses told us that this was largely the result of the senior management time taken up by the lengthy negotiations to extend the contract shortly after the original contract had been finalised, and the pressing operational imperatives to ensure that the additional services were delivered in time for the opening of the Assembly. The Permanent Secretary recognised this weakness and assured us that partnership at the strategic level would be a key priority for Merlin, with the Permanent Secretary himself jointly chairing a partnership committee.⁵⁴ **We recommend that the effective operational relationship between the Assembly and the contractor is maintained under Merlin, and is enhanced by a more effective strategic partnership.**

⁵⁰ AGW Report, paragraphs 4.14 to 4.17

⁵¹ Qs 27, 51 and 183

⁵² Q173

⁵³ AGW Report, paragraphs 4.19 to 4.24

⁵⁴ Q169

28. We were interested to note the case study in the Auditor General's report which shows the Health and Safety Executive establishing a user group to feed into the arrangements for managing their information technology infrastructure contract.⁵⁵ The Head of Business and Information Systems Division confirmed that officials were looking carefully at user involvement in other organisations.⁵⁶ The Permanent Secretary also indicated that he intended Merlin to provide much more differentiated services to meet more fully the particular information and communication technology needs of individual users. He saw the 'one size fits all' approach under Osiris as a limiting factor in the Assembly's current use of information and communications technology.⁵⁷ **We recommend that 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 which better meets their needs.**
29. Another important component of effective contract management is the development of a robust framework for the evaluation and review of the costs and benefits of the contract. The Auditor General reported that there was no such process in place for the Osiris contract.⁵⁸ The Permanent Secretary confirmed that there had been no regular process of review and evaluation and that a one-off report by the Assembly's Internal Audit Service had been delayed, although this would be available in time to inform the Merlin procurement.⁵⁹ We agree with the Permanent Secretary that the absence in-built review for Osiris is a serious limitation and **we recommend that a process of regular evaluation and review be built into the Assembly's contract management arrangements from the outset of the Merlin contract.**
30. We also learned from the Auditor General's report that the Assembly had made only limited use of the open book accounting provisions in the Osiris contract.⁶⁰ Although we recognise that such provisions simply gave access to SBS's books and were not connected to contractual mechanisms, such as profit sharing or clawback provisions, the use of open book accounting could have helped to develop a culture of transparency and openness. The use of open book accounting would also have enabled Assembly officials to provide more accurate

⁵⁵ AGW Report, Figure 13

⁵⁶ Q178

⁵⁷ Qs 77, 167 and 193

⁵⁸ AGW Report, paragraphs 4.27 to 4.28

⁵⁹ Q182

⁶⁰ AGW Report, paragraphs 4.29 to 4.33

figures relating to SBS's profit margin (paragraphs 10 and 11 above). We recognise that, as witnesses told us, this is another area where the Osiris contract shows its age.⁶¹ However, we consider open book accounting an essential element of managing partnerships of this type with the private sector, and **we recommend the full use of open book accounting within the Merlin contract, linked to mechanisms such as profit sharing.** We view open book accounting linked to mechanisms for profit sharing as the key means of securing a good deal from PFI contracts.

Summary of recommendations

31. In the light of these findings and conclusions we recommend that:

- 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 financial impact;
- ii) future contracts include mechanisms such as discounts or charge banding to protect the Assembly against unlimited exposure to key risks;
- iii) future contracts allow greater transparency about profits made by the private sector and include clear profit sharing arrangements;
- 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;
- 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.
- vi) the Assembly takes steps to improve accountability for expenditure on Osiris and its successor contract, ideally through delegation, so that those responsible for staff recruitment within the Assembly take account of the total employment-related costs, including the information technology overhead;

⁶¹ Q183

- vii) the Merlin contract contains a break clause under which the service credit regime is reviewed after each technology refresh;
- viii) the improvement of the speed with which remote users can access the Assembly network be a key priority of the Merlin procurement;
- 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;
- 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;
- xi) the effective operational relationship between the Assembly and the contractor is maintained under Merlin, and is enhanced by a more effective strategic partnership;
- 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 which better meets their needs;
- xiii) a process of regular evaluation and review be built into the Assembly's contract management arrangements from the outset of the Merlin contract; and
- xiv) the Assembly uses open book accounting fully within the Merlin contract, linked to mechanisms such as 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.

Concluding comments

32. The story of Osiris illustrates well the potential advantages and disadvantages of entering into innovative contracts with private sector partners. The original system was rolled out very quickly and its subsequent extension in time for the opening of the Assembly was delivered to an extremely challenging timescale. The system has been viewed with some envy from other parts of the United Kingdom and by visitors from overseas. Although Osiris services have been generally of good quality, the slow speed with which remote users have been able to

access the network – not a function of Osiris itself - must be addressed in order to improve the way the Assembly operates.

33. However, while the initial Osiris contract was a good deal for the then Welsh Office, this was less so after the contract had been extended to meet the additional needs of the new National Assembly for Wales. The negotiating team faced a uniquely challenging set of circumstances, which it is difficult to imagine being repeated. They were able to negotiate a substantial reduction in SBS's initial offer but significantly under-estimated the number of users. Consequently the Assembly has paid more for services than they might otherwise have done. This was exacerbated by the inflexibility of the contract itself which, as the first of its type, did not benefit from some of the contractual mechanisms which better protect the public sector and characterise more recent PFI contracts.

34. Modern government depends on the effective use of information and communications technology. The Osiris contract has contributed to this process in Wales. The forthcoming Merlin procurement represents a golden opportunity for the Assembly to use the many lessons arising from Osiris to develop a contract that will deliver better value for money and quality of service. Primarily we expect to see a more flexible contract and service, with the interests of the Assembly better served through more sophisticated investment appraisal before the contract is signed, and a contract that is more effective in sharing risk and reward in changing circumstances. We view open book accounting linked with mechanisms for profit sharing as key to the achievement of value for money.



Cynulliad National
Cenedlaethol Assembly for
Cymru Wales

HYSBYSIAD I'R WASG PRESS RELEASE

Audit Committee publishes report on Osiris IT system

The National Assembly Audit Committee publishes its report 'Osiris: The PFI Contract for information technology in the National Assembly for Wales' on Tuesday, 25 February.

The report recognises that Osiris was the first PFI contract of its type in the UK and commends several aspects of contractual performance, including the speed of rollout, especially of the extended services to meet the additional needs of the new Assembly, and the generally high quality of the services provided.

The Committee's report does express a number of concerns; about the extent to which costs rose above those forecast largely as a result of increases in user numbers particularly after devolution; the failure to conduct sensitivity analysis on the potential impact of increased user numbers – a key risk - at the time that the contract was extended; and the lack of effective control of the Osiris budget, which was held centrally but affected by local decisions. The Committee also noted the failure to identify the possible implications of devolution at the time the contract was drawn up.

The Committee has welcomed the Permanent Secretary's assurances that he is taking steps to improve budgetary accountability for expenditure on Osiris. The Committee recommends that the Assembly ensure that effective open book arrangements are built into future contractual arrangements.

The Committee has also expressed concern about the slow speed with which remote users of the network are able to access Osiris. Although this is a consequence of the telephonic infrastructure in Wales, the Committee stressed that this issue had a negative impact on the level of service they are able to provide to their constituents. The Committee recommended that the

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Merlin procurement should prioritise the improvement of the speed with which remote users can access the Assembly's network.

The Merlin contract, which will replace Osiris, is due to be let later this year, to start in January 2004. This Committee report will contribute to learning the lessons of Osiris and applying them to Merlin to develop a more sophisticated contract that will offer better value for money and quality of service.

The report 'Osiris: The PFI Contract for information technology in the National Assembly for Wales' is available from 00.01 Tuesday 25 February 2003, at www.wales.gov.uk under Assembly Committees.

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HYSBYSIAD I'R WASG

EMBARGO TAN 00.01AM DDYDD MAWRTH, CHWEFROR 25

Y Pwyllgor Archwilio yn cyhoeddi adroddiad ar system TG Osiris

Bydd Pwyllgor Archwilio'r Cynulliad Cenedlaethol yn cyhoeddi ei adroddiad 'Osiris: Y Contract Menter Cyllid Preifat (PFI) ar gyfer technoleg gwybodaeth yng Nghynulliad Cenedlaethol Cymru' ar ddydd Mawrth, 25 Chwefror.

Mae'r adroddiad yn cydnabod mai Osiris oedd y contract menter cyllid preifat cyntaf o'i fath yn y DU ac mae'n cymeradwyo nifer o agweddau ar berfformiad cytundebol, gan gynnwys pa mor gyflym y mae'n cael ei gyflwyno, yn enwedig y gwasanaethau estynedig i ddiwallu anghenion ychwanegol y Cynulliad newydd, a safon uchel y gwasanaethau a ddarparwyd yn gyffredinol.

Mae adroddiad y Pwyllgor yn mynegi nifer o bryderon; ynghylch i ba raddau y mae'r costau wedi codi'n uwch na'r rhai a amcangyfrifwyd o ganlyniad i'r cynnydd yn nifer y defnyddwyr yn arbennig ar ôl datganoli; y methiant i gynnal dadansoddiad sensitifrwyd o effaith bosibl y cynnydd yn nifer y defnyddwyr - risg allweddol - ar adeg ymestyn y contract; a diffyg rheolaeth effeithiol o gyllideb Osiris, a oedd yn cael ei dal yn ganolog ond yn cael ei heffeithio gan benderfyniadau lleol. Nododd y Pwyllgor hefyd y methiant i nodi goblygiadau posibl datganoli pan luniwyd y contract.

Mae'r Pwyllgor wedi croesawu'r sicrwydd gan yr Ysgrifennydd Parhaol ei fod yn cymryd camau i wella atebolrwydd cyllidebol y gwariant ar Osiris. Mae'r Pwyllgor yn cymeradwyo y dylai'r Cynulliad sicrhau bod trefniadau llyfr agored effeithiol yn gynwysedig mewn trefniadau cytundebol yn y dyfodol.

Mae'r Pwyllgor hefyd wedi mynegi pryder ynghylch arafwch y mynediad i Osiris gan ddefnyddwyr y rhwydwaith o bell. Er bod hyn yn ganlyniad isadeiledd teleffonig yng Nghymru, pwysleisiodd y Pwyllgor fod gan y mater effaith negyddol ar lefel y gwasanaeth y gallant ei ddarparu i'w hetholwyr.

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Argymhellodd y Pwyllgor y dylai proses gaffael Merlin roi blaenoriaeth i wella'r cyflymder y gall defnyddwyr o bell gael mynediad i rwydwaith y Cynulliad.

Bydd contract Merlin, a fydd yn disodli Osiris, yn cael ei ddyfarnu yn ddiweddarach eleni, i ddechrau ym mis Ionawr 2004. Bydd adroddiad y Pwyllgor yn cyfrannu i ddysgu gwersi Osiris a'u cymhwyso i Merlin er mwyn datblygu contract mwy soffistigedig a fydd yn cynnig gwell gwerth am arian a gwell ansawdd gwasanaeth.

Mae'r adroddiad 'Osiris: Y Contract Menter Cyllid Preifat (PFI) ar gyfer technoleg gwybodaeth yng Nghynulliad Cenedlaethol Cymru' ar gael o 00.01 ddydd Mawrth 25 Chwefror 2003, yn www.cymru.gov.uk, o dan Pwyllgorau'r Cynulliad.

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