

21 February 2012

Scrutiny of Procurement Lincolnshire

Report of Scrutiny Committee to South Kesteven District Council's Cabinet

Summary of Conclusions and Recommendations

1. The importance of procurement is only likely to increase in the future as local authorities generally move further in the direction of becoming contracting out bodies. It is clear that Procurement Lincolnshire has been a big success and should continue to be; however care needs to be taken with its pre-occupation about headlining its 'savings'. We **recommend** that the Lincolnshire Procurement Advisory Board requires Procurement Lincolnshire to set out clearly the definition of its reported 'cashable savings' to its partner local authorities and to use this definition in all reports. We suggest that the definition of present practice should be along the lines of:

'savings achieved or expected to be achieved by all current contracts (or the latest contracts to be let) compared with the costs of the previous comparable contracts'

Whilst such a definition might not mean a lot to the man in the street (or the members of Lincolnshire District authorities) it is important that in its absence people are not misled into thinking that the savings are only over the previous situation without Procurement Lincolnshire.

2. We **recommend** that Procurement Lincolnshire, with the co-operation of the Procurement Advisory Board and the Lincolnshire Finance Officers Association should investigate additional ways of measuring success apart from annual cashable savings. In the medium-term cumulative savings may be a better measure. We expect that annual cashable savings in the medium term will peak and decline as Procurement Lincolnshire comes to its second phase of procurement on contracts (as a result of making the biggest saving the first time around). This pattern could be built into forecasts. When this future point is reached, which will not indicate failure, it will be important that partners do not just view annual savings compared with annual costs – both the cumulative savings (currently £9million countywide) must be borne in mind and the protection of these by Procurement Lincolnshire.

3. We note that annual cashable savings reported by Procurement Lincolnshire, even though they are after a year-end, are frequently estimates rather than actuals. The consequence is that different figures appear in different reports and the County total for 2010/11 has a variation of over £1million between reports. This leads to three **recommendations** for the Procurement Advisory Board and Lincolnshire Finance Officers Association to consider with Procurement Lincolnshire. The first is that it should always be stated whether a figure is an estimate or an actual. The second is that there should be a cut-off date after a year end at which actual figures are reported and not changed thereafter. The third is that having both cashable savings that are estimated (even if not stated as such) **and** target savings leads to confusion and a situation which needs resolving (see recommendation 5 , below)
4. We **recommend** that the apparent anomaly of the savings recording system not recording any increases in contract prices (but only savings) should be addressed by Procurement Lincolnshire, the Procurement Advisory Board and the Lincolnshire Finance Officers Association, as this situation spoils the integrity of the system.
5. We endorse the conclusion of the Joint Lincolnshire Scrutiny Panel that the declared targets of Procurement Lincolnshire are meaningless. We agree with its recommendation that savings targets should be based on the previous year's results. These targets should not be lower than the estimated projection of savings from existing contracts (as they are at present). The forward programme of contracts to be procured should inform the uplift to be targeted over and above the forecast savings from existing contracts. We **recommend** that Procurement Lincolnshire or its management body (Procurement Advisory Board) produce a report on this for approval by the management body.
6. We **recommend** to SKDC's Cabinet that full advantage is taken of collaborative procurement with other districts as recommended by Procurement Lincolnshire. We found no evidence of officers at SKDC dragging their feet on co-operation with Procurement Lincolnshire in broadening its scope as reported in a non-specific way in its 2010/11 annual report.
7. We note that Recommendation 2 of the Joint Lincolnshire Scrutiny Panel is that its final report should be circulated to *"the relevant scrutiny committee at each of the partner authorities."* We understand that this report was considered by the

Lincolnshire Leaders and Chief Executives Group in July 2011 but it was not received by SKDC Scrutiny Committee until November 2011 and only then after several requests. We **recommend** that future scrutiny reports are circulated promptly.

8. We regret that the recommendation of the Joint Lincolnshire Scrutiny Panel in its report to change the governance arrangements for Procurement Lincolnshire to a simpler structure and a body comprising only elected members (with officer support) rather than also officers has apparently not been implemented. We were going to **recommend** that SKDC was given the opportunity to have councillor representation on this new body. We understand that the only governance change brought about to date is that the chairman of the Procurement Advisory Board has been made accountable to the Lincolnshire Councils' Joint Leaders and Chief Executives. We observe that therefore there are only three elected members on the Procurement Advisory Board. We consider this unfortunate and **recommend** that the members of the Joint Lincolnshire Scrutiny Panel are appraised of this situation (notwithstanding its disbandment) and that the Procurement Advisory Board and the Joint Leaders and Chief Executives are invited to explain why the original recommendation of the Joint Lincolnshire Scrutiny Panel for a simpler single governance body has not been followed through.

Purpose of this report

This report is the result of a high level scrutiny review by South Kesteven District Council's (SKDC's) Scrutiny Committee (The Committee) into the level of success and value for money of Procurement Lincolnshire (PL) since its establishment in 2008/9.

The report is based upon the following information only:

- A presentation by PL to the Committee on 27 September 2011
- The Review of Procurement Lincolnshire Final Report April 2011 by the Joint Lincolnshire Scrutiny Panel (JLSP), upon which there is district as well as county council member representation , but no representation of SKDC
- The 2010/11 Annual Report/Summary of Three Year Review by PL
- Questioning of SKDC officers at The Committee's meeting on 29 November 2011
- Interviews with Richard Wyles, Chief Financial Officer of SKDC and Alina Hackney , PL
- The PL spreadsheet used for calculating savings
- The PL Partner Liaison Quarterly Review report for SKDC 19 December 2011

Essential Facts

The Committee notes the following essential facts:

- PL was set up by Lincolnshire County Council and the seven Lincolnshire district councils to provide a central procurement service for all appropriate procuring and purchasing of works, goods and services utilising economies of scale and expertise.
- PL was established in April 2008, so it has completed three years of operation and is now well through its fourth year. The first year, however can properly be regarded as a start-up year.
- PL had an establishment of 26.5 officers as at July 2011, with two posts vacant (source: 2010/11 Annual Report), although we understand that 8.5 of these are funded directly by the County Council rather than through joint arrangements
- PL reports £9,007,000 of cumulative 'cashable savings' to the County Council and seven district councils as at July 2011 with £4,125,000 of this being in 2010/11 (2010/11 Annual Report)
- PL reports £370,000 of cumulative 'cashable savings' for SKDC of which £198,000 was in 2010/11 (dated as at 05/07/2011 in the 2010/11 Annual Report).
- The current charge to SKDC is £35,000 based on a flat fee element for each district of £15,000 with the remainder based on forecast annual savings over the first five years.
- PL is not a 'tender factory' and advises on whether tendering is the best or only form of procurement, it advises on how the districts might purchase smaller items themselves (for example through Procurement Cards) and transfers knowledge to district officers on the whole procurement legislative background. It also helps with tender evaluation and forms of contract, bearing in mind that as it is not a legal entity it will always be one of the eight partner authorities that lets the contract.
- PL also has a major role in training local contractors about tendering procedures.

Reported Savings

We observe that the amount of cashable savings reported seems to vary between reports. In the PL 2010/11 Annual Report the 2010/11 savings for South Kesteven are stated as £197,615 as at 05/07/2011 whereas in the more recent (December 2011) PL Partner Liaison Quarterly Review report for South Kesteven they are stated as £183,599. The comparable County figures are given as £4,125,170 and £3,129,220, which is a rather greater discrepancy. We believe that even if the explanation is that one figure is an estimate and the other a later estimate or an 'actual' this should be clearly stated and there should be an agreed date at which actual figures are finalised.

The report of the Joint Lincolnshire Scrutiny Panel (JLSP), the 2010/11 PL Annual Report and the presentation to The Committee by PL have all focused heavily on the savings claimed by PL. However none of them explain the definition these savings.

From the start of this review we have asked ourselves the question 'savings compared with what?' You cannot have savings unless the new expenditure is compared with a clear definition of previous expenditure (the 'after' and 'before'). It must be obvious what the new level of expenditure is (although exact figures cannot be finalised until after the end of a financial year) but the 'before' expenditure definition is missing. Indeed when the JLSP wrote its report we believe it did not have any clear understanding of this either, or failed to see that it was an issue, focusing instead on savings targets being 'not ambitious enough' (we cover this matter later).

This lack of clarity of 'savings compared with what' is a pertinent matter given the scale of the savings being claimed by PL – over the three years £9m across all the local authorities and £370,000 in South Kesteven.

The reader might suppose that the savings being claimed are the savings that PL has brought about compared with what would have happened without it. However our investigations have revealed that this is not the case and that the definition would seem to be **'savings achieved or expected to be achieved by all current contracts (or the latest contracts to be let) compared with the costs of the previous comparable contracts'**. The previous comparable contracts can be either those tendered by the individual authorities or by PL, so clearly as time moves on, if the same definition is used savings can be expected to diminish substantially as current PL tendered contracts are compared with previous PL tendered contracts (rather than with local authority tendered ones).¹

At present in South Kesteven only some contracts have been re-tendered by PL or with PL's help since 2008, for example housing capital contracts. Many of the larger revenue contracts remain to be re-tendered by PL because they run for periods of five or seven years so have not come up for re-tendering yet. At present being tendered is the vehicle fleet contract; scheduled for 2012 is the audit contract; for 2013 the grounds maintenance and insurance contracts and for 2015 the leisure contract. PL's success demonstrates that as these contracts come up for re-tendering by PL substantial savings are likely to be made, at least for the first time for each because of the economies of scale (sometimes two or more districts can be joined together) and the specialist expertise of PL staff. However logically we can expect far less savings when contracts are tendered by PL for the second time, because the expertise has already been applied the first time. This expected peaking of annual savings is not likely to happen before the medium term because for some time there will be more procurement for the first time than for the second time (several major services are still to be procured by PL for the first time – see SKDC examples, above).

Within the scope of this review it has not been possible for us to predict accurately when savings, as we have defined them, will peak, as this depends upon a complex web of contracts across the eight authorities with different expiry years but this could be calculated by PL itself and our best guess would be in four to five years time. One way of looking at this is that an exceptional performance by PL in a first re-tendering may be hard to beat in a second re-tendering.

When annual savings decline, possibly eventually to a level below annual running costs it will be necessary for PL to have alternative success measures than annual savings. Return on Investment (ROI) is another current measure calculated by dividing the annual 'cashable savings' for each partner by its annual financial charge) but will also be unhelpful when this point is reached as it will decline and possibly even go negative. 'Cumulative savings' on the other hand will be likely to be of key importance because PL will always carry forward its built-up success and no doubt, without PL's present activity, there would be erosion of the savings it has already achieved which would represent real extra costs to the partner authorities.

Of course while this process of accelerating and then peaking savings is going on, there will be natural market forces in play which will tend to make contracts either more or less costly. It is evident that in the early years the expertise and economies of scale applied by PL have very much outweighed such forces but after the expertise has been applied once they might have a more significant bearing.

Our comments are directed very much at the way in which performance is measured by PL and should not in any way be taken as a criticism of the concept of PL. The people we have talked to have also suggested that another way should be found of measuring PL's performance than the current single claims of (undefined) savings. We have no specific proposals for this but it should be investigated. The first step however is for the savings to be defined along the lines we have suggested so that they are not misleading.

Of course concentrating on cumulative savings, which PL already measures along with annual savings, will be likely to justify PL's existence for a long time even when annual savings fall off (paradoxically due to the very success of the organisation).

A full economic appraisal of PL, along Treasury Green Book lines, would look at the 'counter-factual' case or what would have happened anyway without PL. It is possible that the eight authorities might have made some of their own savings due to some (but more limited) expertise, collaboration and market factors but this scenario would be almost impossible to simulate. One way of looking at this hypothetical counter factual case would be to say that if the 28 staff working for PL were to be allotted to the eight authorities instead they would have 3 to 4 procurement specialists each, which is probably more than they would have had prior to PL – they could therefore expect to achieve some savings themselves. However this ignores the undoubted ability that PL has, with its critical mass, of attracting the best

procurement staff. It is also evident that with PL in operation the time of senior officers at South Kesteven and the other partner authorities is freed up for other activities including contract management.

The 'cashable' savings incurred by PL are rightly held to justify its costs. We do not know the cost of PL's 28 staff posts but logically it is far less than the £9m 'saved' over the first three years. The charges to the individual partner authorities look to be extremely good value for money when compared with the savings made (this is the Return on Investment). South Kesteven paid only £35,000 into PL per annum, in return for £183,000/£198,000 of savings in 2010/11. Even one procurement expert at SKDC would have cost at least £50,000 gross.

So at present there is no concern about the running cost of PL (largely staff costs) as it is more than justified by the 'cashable savings'. When the point is reached in the medium term that PL is no longer making major additional savings year on year (but is still achieving best value) not only might the performance measure need to change but also there is likely to be increased focus on running costs as these could begin to exceed year on year savings and become real costs requiring funding from other budgets (this is not to say that PL will become of less worth, it is just that most of its saving will be historic and must be maintained).

The Annual Report and Three Year Review states that 'savings are captured using a recording method which has been agreed with partners'. A spreadsheet model is used for this purpose (the Efficiency Savings Calculation Sheet). The crucial input to this model seems to us to be the 'Baseline Cost' (this is what we have previously referred to as the 'existing cost' of the contract) because the 'New Cost' is more factual. There is some good advice on ensuring that these two figures are comparable but the entries are left to an array of officers in the eight authorities and would naturally be subject to human variation. An audit of these entries would therefore be a good idea. The fact that chief financial officers sign these entries off does not mean that they are necessarily consistent across the County.

The savings data collection system (via the spreadsheet) is run by the Lincolnshire Finance Officers Association (LFOA) rather than PL itself. This body is due to meet in February 2012 to consider priorities for PL for the next 3 years and no doubt will take into account both the JLSP report and this report. One additional observation we have made on the method for collecting savings data is that we could not see, at individual contract level a single case of an increase in cost (or negative saving). One would naturally expect to see just one or two occurrences of this but on enquiring we were told that only cost savings are measured, not cost increases (in line with National Indicator 179, on Value for Money). This does seem bizarre and seems to counteract the integrity of the system.

We note that percentage confidence levels are used 'in year' to indicate the accuracy of estimates of 'cashable savings' based on 'running' contracts but these are not applied mathematically as probabilities to any of the forecasts.

Target Savings

Our brief review has not shed any light on how 'target savings' are set. We note that the JLSP said at its Recommendation No 5:

"The Group believes that the original savings targets set for Procurement Lincolnshire were not sufficiently ambitious and support the setting of more challenging but realistic targets in future. It is also recommended that the savings targets are set on an annual basis to take in to account recent performance and prevailing economic conditions."

We would agree with this sentiment although we believe it skips over the practicalities. First it skips over the whole matter of how savings are defined (see above). Second it skips over how savings targets are set. Both the Annual Report and Quarterly Review and their graphs shown to us by SKDC and PL officers continue to compare 'cashable' savings with target savings and whilst we have made recommendations about tightening up the definition of 'cashable' savings and being prepared for them to decline in the medium term we remain puzzled about how target savings can be set consistently and methodically, without being largely subjective. It seems that the JLSP was not impressed by previous target savings being greatly exceeded, perhaps to paint PL in an even better light. We agree that these targets have appeared to be meaningless. Do we really need to compare new costs with some concept of target costs as well as with existing or previous costs? How can such targets be rationally set when savings are largely a result of the complex set pattern of contract renewal by partner authorities?

The need for target savings appears to diminish when it is understood that 'cashable' savings (or actual savings) are also forecast by PL for several years ahead. In the Quarterly Review 'cashable' savings are forecast up to seven years ahead (further ahead than the spurious target savings). This forecast shows SKDC's 'cashable' savings increasing annually from £285,000 in 2011/12 to £373,000 in 2013/14, then dropping off slightly to £312,000 in 2014/15 and down to £82,000 in 2015/16 (see Appendix 1 which is taken from the Partner Liaison Quarterly Review December 2011). These forecasts are purely an analysis of contracts already running and their expenditure in all the years of their duration – this is not just factual information as many contracts whilst having fixed rates do not have fixed quantities that these rates are applied to. To take the JLSP's recommendation No 5, targets based on "recent performance" might be based on the forecast cashable savings plus a percentage uplift, say 10% or 20% (the percentages would need to reflect the number of new first time PL procurements expected in the next year, information which PL is now in an advanced state of obtaining from the Districts).

To interpret the JLSP's recommendation more simply, annual performance could (and can now) be measured simply by comparing the amount of savings made in one year compared

with previous years. Targets on this basis might be developed but they would need to relate to the complex web of the progression of first and second let contracts going through the system and reflect the fact that big savings will be less likely when all contracts have at least once been procured by PL.

Co-operation/Collaboration

PL's Summary of the Three Year Review states at page 13 in "Key Points" that:

"In order to accelerate the pace of savings delivery, there needs to be greater uptake of collaborative procurement. Accountability for savings delivery should ideally be jointly owned by partners and PL. Savings delivery cannot be achieved by PL in isolation – success requires the full cooperation and involvement of partner authorities."

We do not know what hidden message there might be in this key point nor whether it is evident in the full review but would point out that the pattern by which South Kesteven contracts, at least, come up for re-procurement by PL is largely dictated by their set expiry date (and we have already pointed out that revenue contracts can run for 5 or 7 years). It is therefore hard to accelerate the pace of retendering. That accountability for savings delivery should be "jointly owned" is an admirable objective in a partnership but the actual improvements are primarily the job of PL; that "success requires the full cooperation and involvement of partner authorities" seems obvious – does this mean that PL thinks that more procurement should come its way? Our brief investigation at SKDC only, points towards both it not being easy for large contracts to be re-procured by PL any faster and it not being sensible for smaller scale purchasing to be conducted centrally (thus remaining with the district authorities).

On page 14, the Summary states that "There is largely strong support for PL at senior levels (at the partner authorities) but that "support can sometimes become diluted at the Head of Service level and below". It goes on to say "Some officers still perceive PL as a threat to their decision making authority or status – this is recognised and needs to be managed jointly". We can only say that our brief investigation at South Kesteven District Council shows nothing but support for PL amongst officers.

Our interview with PL officers reveals that by "collaborative procurement" refers especially to joint procurement between districts which has clear potential for savings due to economy of scale. A single contract can be arranged with staggered start dates so districts' contract periods being out of line is not necessarily a reason for not partaking in such collaboration. An example was given to us of a framework contract for a single district, housing in North Kesteven, which could be applied also to other districts – including possibly SKDC.

PL have pointed out to us that sufficient data to fully explore such inter-district collaboration has only been available since summer 2011 so it can be expected that further advances and savings will now be made in this manner.

Training

PL, in addition to providing tendering training for local businesses, which is very well praised by Lincolnshire Chamber of Commerce (see 2010/11 Annual Report) also provides extensive training to the officers of the district council partners. In 2010 there were over 300 attendees at 27 training sessions. This has covered specification writing and contract and supplier relationship management as well as electronic tendering so helps partner staff in the wider business of out-sourcing as well as the changing legislative environment to procurement. Some 40 officers from SKDC have attended these sessions so dissemination is down to middle management level and below. Feedback from lead officers at SKDC is favourable.

Administration

We note that Recommendation 2 of the JLSP is that its final report should be circulated to “the relevant scrutiny committee at each of the partner authorities”. We would point out that the report, produced in April 2011 did not reach members of SKDC’s Scrutiny Committee in this way and SKDC officers on behalf of The Committee had to ask for the report more than once before it finally arrived with Scrutiny Committee in November 2011.

Governance

We welcomed the recommendation of the Joint Lincolnshire Scrutiny Panel in its report to change the governance arrangements for Procurement Lincolnshire to a simpler structure and a body comprising only elected members (with officer support) rather than finance officers as at the time (The Lincolnshire Finance Officers Association). We were going to propose that SKDC was given the opportunity to have councillor representation on this new body. However we note that this proposal has apparently fallen by the wayside and that the previous governance structure lives on with Procurement Lincolnshire still being managed by the Procurement Advisory Board jointly with the Lincolnshire Finance Officers Association. The only change seems to be that in July 2011 it was agreed that the chairman of the Procurement Advisory Board would be held accountable to the Lincolnshire Councils Joint Chief Executives and Leaders. We observe that this means that there are only still three elected members on the Procurement Advisory Board. We consider this unfortunate and believe that the members of the Joint Lincolnshire Scrutiny Panel should be appraised of this situation (notwithstanding its disbandment) and that the Procurement Advisory Board and Chief Executives should be invited to explain why the original recommendation of the Scrutiny Panel have apparently been ignored.

1 February 2012

Note

¹ This explanation is complicated somewhat by the fact that the glossary to the PL savings calculation spreadsheet also allows the baseline comparison to be simply the contract prices in 2007/8 instead of the previous prices. Whilst these could amount to the same thing this advice to partner authorities causes some confusion as it is not clear whether the 2007/8 figures are an option or simply a default. Advice in this respect needs clarifying so that there is a simple understanding of the definition of 'cashable savings' recorded by PL that members of the partner authorities and the public can understand and so that the reported results are on a consistent basis. The fact that this advice refers to National Indicator 179 on Value for Money, does not in itself mean that it is helpful.