Strategic Asset Management

Issue 17, Aug 27th, 1999



# Yours, theirs, or ours?

## Responsibilities in Performance Based Contracting

There is increasing interest in performance based contracting, especially in the area of roads.

Roads are a major asset for all levels of government and the cost of road transport is a major issue for many industries. Roads are visible, road performance affects everyone, and there are powerful lobby groups arguing for better performance and/or more money to be spent.

**If performance based contracting can survive and thrive in the road maintenance area, it has prospects everywhere!**

Schedule of Rates? Lump Sum Short Term? Lump Sum Long Term? Mixed Schedule of Rates and Lump Sum? What works? What doesn't? Join the discussion on this important topic in the new weblink forum

**"Performance Based Maintenance Contracting"**

New Discussion Forum

This weblink is being moderated by Tim Provis and Ashay Prabhu of the Civil Construction Company, Peter Fortune from Brimbank City Council and Rodney Deane, a consultant with Sinclair Knight Merz at

www.amqi.com

Tim Provis and Ashay Prabhu, Civil Construction Company, Tasmania –joint winners with Brimbank City Council of the Australian Local Government Award for Asset Management Excellence in the 1998/1999 International Asset Management Competitions - have prepared a background paper which you will find on the above website. See also "The Contract Advantage" pp130, 134 and "Views on PBMC" pp134-1345.

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# The Contract Advantage:

Characteristics of the Major Contract Types

*Extract from Ashay Prabhu and Tim Provis "Outsourcing" - full background paper can be found on website: www.amqi.com/contracting.htm*

## 1. Schedule of Rates

This type of contract requires specific activities to be performed for fixed rates, these activities are usually defined by method or product type specifications. Work is performed on an as ordered basis and performance is measured in empirical terms based on the work conforming to the required standards. These contracts are often limited to routine type activities but may also include some periodic type activities.

### Characteristics

- *Individual activities identified as scheduled items with estimated quantities.*
- *Performance specified in terms of product quality or work method.*
- *Most risk accepted and managed by the client*
- *High levels of administration by client*
- *High levels of expertise and knowledge held by the client*
- *Low risk level to provider*
- *Low levels of management required by provider*
- *Little opportunity for innovation by provider*
- *Low level of influence on asset condition by provider*
- *Easy entry of providers without history of road maintenance delivery.*

## 2. Lump Sum Fixed Term

In this type of contract a range of activities are required to be performed for a fixed lump sum, in these short term contracts the scope is usually limited to routine activities with separate arrangements made for periodic activities. Performance is measured by the repair of defects within specified limits of time and quality.

### Characteristics

- *Often separated into work packages such as roadside vegetation, traffic facilities pavement etc.*
- *Variable levels of risk for both clients and providers depending on packaging.*
- *Intervention level and/or frequency of service used to define requirements and performance.*
- *Some opportunities for innovation by providers.*
- *Usually high levels of administration and inspection by client.*

## 3. Mixed Schedule of Rates and Lump Sum

This type of contract generally contains separate parts with the more minor reactive routine activities covered by the lump sum component and the less predictable or larger activities cover by the schedule of rates component. The range and division of activities varies widely in this type of contract, as do methods of measuring performance.

### Characteristics

- *Increased levels and acceptance of risk by provider*
- *Requirement for performance definitions and measurement criteria.*
- *Reduced levels of administrative effort by client*
- *Reduced levels of resources and expertise required by client*
- *Increased levels of technical and management expertise required by provider.*
- *Opportunities for innovation by provider to reduce costs*
- *Greater reliance on cooperative relationships between clients and provider organisations*
- *Specification and scope design is critical to ensure that client expectations can be delivered.*

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## Service Level Agreements: Part 5

# SLA Management

- *Over the past few issues, Sara Cullen has provided information on how to develop a service level agreement. Here Sara focuses on managing SLAs and provides checklists for activities and skills.*

*Organisations across Australia are increasingly moving towards competitive tendering, contracting, purchaser/provider models and SLAs for the management of services. As a result, managing internal and external agreements is becoming core to overall business management.*

*The changing nature of SLAs means that the responsibility transcends the traditional, more administrative role. To manage today's SLAs, a direct role must be played at a strategic and operational level to ensure value for money is achieved and risks are minimised.*

### The scope of a SLA Manager's ongoing activities include:

- ✓ **Applying** - performance penalties and/or rewards (if specified).
- ✓ **Assessing** - performance and cost trends each reporting period and over the life of the SLA; need for changes to personnel, policy and procedures.
- ✓ **Auditing** - compliance with the SLA provisions, internal controls, performance, billing information, and "open books".
- ✓ **Benchmarking** - costs and/or performance levels with industry standards and leading practice.
- ✓ **Communicating** - to all affected stakeholders any potential changes to both organisations and the impact on their objectives and the services provided.
- ✓ **Developing** – an ongoing improvement agenda to ensure continuous improvement of services, the relationship and the use of IT.
- ✓ **Documenting** - all formal and informal communications within the organisation and between the parties in a systematic manner that provides an audit trail.
- ✓ **Forecasting** - volume and capacity of services required and cost.
- ✓ **Keeping informed** – emerging technologies, industry standards, market prices, use of subcontractors, and of changes to financial and organisational situation that may affect the contract.
- ✓ **Implementing** - variations to the SLA and documentation to reflect changes in best practice, requirements, performance levels, etc.
- ✓ **Liaising** - with internal management and users and between the parties regarding issues and feedback .

- ✓ **Meeting** - regularly with both parties regarding strategic, performance and operational issues.
- ✓ **Monitoring** - performance levels, volume levels and the organisation's effective use of the contractor.
- ✓ **Negotiating** - desired changes to the arrangement by either party and resolution of issues and disputes.
- ✓ **Planning** – service and business continuity in event of service or contractor failure.
- ✓ **Preparing** - for the end of the SLA, both the conclusion of the natural term or early termination.
- ✓ **Reporting** - achievement of strategic and operational goals of the services contracted and the SLA itself.
- ✓ **Structuring** - management/operational accountabilities and processes internally and between the parties.
- ✓ **Verifying** - invoices for payment and appropriateness of requests for service changes by either party.

## Skills that need to be accessible by the SLA Manager

**Financial skills:**

- ♦ **Accounting** – particularly with financial reporting
- ♦ **Cost management** - assessment, modelling and tracking
- ♦ **Pricing** - options and sensitivity analysis

**People skills:**

- ♦ **Communication** - identification of two-way needs and application of techniques
- ♦ **Liaison**- interpersonal skills and networking
- ♦ **Negotiation** - strategy, conduct and administration
- ♦ **Organisational change** - planning and directing behaviours to achieve objectives
- ♦ **Relationship management** - to transcend traditional adversarial supplier/customer relationships to a partnership

**Process Skills:**

- **Administrative** - record keeping, approval processes, distribution and control
- **Forecasting** - use requirements and business change impacts
- **Organisational alignment** - restructuring processes and accountabilities to meet the needs of contract execution
- **Planning** - all aspects of strategic and operational management, and for contract end
- **Problem management** - timely identification and resolution
- **Project management** - setting in place and monitoring the tasks, resources and timing required to accomplish the activities required
- **Quality management** - best practice, industry standards, etc
- **Reporting** - design and preparation

**Specialist Skills:**

- **Auditing** - SLA compliance, internal control, performance levels and cost
- **Contract law** - particularly variation, intellectual property rights, dispute resolution, remedy and termination
- **Performance management** - measures, reporting, and benchmarking
- **Risk management** - identification and minimisation
- **Technical skills** - in the services being provided to accept quotes and deliverables, assess performance, and scope requirements

## In the next issue: *Your* Questions on SLAs

Sara Cullen is a senior manager at Deloitte Consulting with 16 years experience in outsourcing.

**1.** Sara will answer your questions in the next issue. If you have not already done so, email them directly to her at sacullen@dc.com or to sam@amqi.com

**2.** Sara's 2 day workshops in negotiating, establishing, implementing and managing Service Level Agreements will be repeated in November. The times and places have yet to be finalised but information will placed on the www.amqi.com website on the conference page when available.

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- *Contract term should be longer to allow benefits of improved delivery and management to be realised.*
- *Ideally Lump Sum activities should reflect activities for which a frequency of occurrence can reasonably be estimated and/or those for which occurrence can be influenced by the provider. Schedule of Rates activities should then include those activities for which it is unreasonable to estimate a quantity or which require providers to accept unreasonable levels of risk.*

## 4. Lump Sum Long Term (Performance Specified)

These are relatively new contract types and their form is far from clear, broadly they allow for the physical owner of the assets to vest in a provider most of the responsibilities of ownership for a significant period usually about 10 years. The degree of this ownership appears to be one of the major issues for performance contracts and the separation of the functions of ownership and the associated risks a major task in their design and development. In most cases the contracts allow for the provider to take up ownership of all but major enhancement or replacement and legislative responsibilities for the majority of assets related to a road network. There are issues as to the physical limitations of this scope such as the inclusion of bridges and other structures, some ancillary assets such as street lighting and traffic signals and some non physical aspects such as social or community services associated with road networks.

## Characteristics

- *Provide stable budget requirement for client.*
- *Considerable risk transferred to provider.*
- *Provider often responsible for specification of work practices and performance.*
- *High levels of asset management required by provider.*
- *Opportunities for innovation by provider to improve effectiveness and efficiency.*
- *Client owned specifications for materials and/or method may limit provider's ability to achieve targets.*
- *Provider requires high levels of confidence in client forward programs to ensure investment in specific treatment is not lost through renewal or upgrade work.*
- *Contractual arrangements often subject to extended negotiation and review.*
- ♦ *Performance measures needed for long and short term.*

Refer: www.amqi.com 'Discussions' for the full discussion paper by Tim Provis and Ashay Prabhu

**DEPRECIATION OF INFRASTRUCTURE ASSETS**
**EXPRESSIONS OF INTEREST**

The South Australian Local Government Association Financial Advisory Committee has received funding from the Local Government Research and Development Scheme to undertake research into the depreciation of local government infrastructure assets, and the relationship of depreciation to the general principles of effective infrastructure asset management. This is a significant project, the outcomes of which will be of interest to local government at the national level.

The Steering Committee established to manage the project is now seeking Expressions of Interest from suitably qualified and experienced consultants interested in undertaking this research.

A copy of the Project Brief and a background Principles Paper are accessible at
**www.amqi.com/eoi.htm**

# Are we ready for PBMC?

## ...and other issues

Respond to these comments or add your own at www.amqi..com

### Are we ready for PBMC?

David Mounter
Construction Manager
Hebou Constructions (PNG) Ltd

In the past there has been a genuine lack of data, knowledge and understanding of the maintenance costs of major civil infrastructure. This is changing, the industry is developing, but is it changing fast enough to keep up with the rapid move to contracting out maintenance tasks?

There are risks for both contractor and asset owner. To minimize risk of failure both must have an understanding of the outcomes that are required, what the important aspects of the work are and be able to communicate with each other. In the contractual situations that I have seen to date this has not been achieved.

Asset performance can be a complex issue and is subject to change with usage patterns. A road network is a very good example of this. The loading patterns can change with demographics, industrial or commercial development or change in legislation.

True cost minimization requires (1) capable contractors-unfortunately there are no barriers to entry and smaller contractors may not appreciate the complexity or be able to handle all the aspects of the contract, and (2) Asset owners must share their knowledge, data and plans for the asset – and may be unwilling to do this.

There is the potential for PBMC to deliver waste reduction and cost savings to society – but are we ready?

### Key to PBMC success is Measurement

Rodney Deane, Consultant -
Sinclair Knight Merz P/L

I work for a consulting engineering company SKM and their subsidiary Maintenance Management Australia (MMA). I have been associated with four outsourced performance based maintenance management contracts (average value $100m) and I have seen the benefits of performance based contracts in cost savings and focus on the maintenance management task.

The key issue is measurement. What data is available? Is it reliable? is it measuring the right things? What are tenderers to do? Can everything be scoped properly? What are the drivers for the contractor to perform with good workmanship around the margins where the performance specification can't go? How literal and technical will the Principal be in requiring adherence to the specified performance or will the Principal and the Contractor be able to work cooperatively towards joint goals?

### Long Term PBMC—First Impressions favourable

Mark Bowerman Senior Supervisor (Network Operations) Dept Transport Hobart

Some of the things that have impressed me so far (12mths + into a long term contract) are:

1. Greater flexibility exists particularly in relation to budgeting and programming of works.
2. Investment beyond 3 years is possible.
3. Smarter maintenance practices, instances where the contractor has made initial investments and as a result of this maintenance expenditure has dropped off.
4. With a schedule of rates contract expenditure for some items can be very erratic, as contractors wait for approval for these items or it is seen as someone else's problem. In our Long Term lump sum contract the money is very much the contractors and there is an incentive toward efficiency. Seasonal conditions and the best place to target expenditure in the network are more likely to be taken into account.
5. Long Term Contracts are more likely to be innovative as smarter work practice will make more money.

## PBMC – An in-house contractor viewpoint

Peter Fortune, Asset Manager
Brimbank City Council

Brimbank Council's in-house team has been successful in a recent outsourcing process, winning a 3 year contract. It would be assumed that if not previously in existence more stringent recording procedures would be implemented as facts and figures will be essential to the Contract Officer to ensure the requirements of the contract are being adhered to. This sort of information when shared will be beneficial to Asset Management in producing Asset Plans.

Unfortunately anecdotal evidence would suggest that communication and expectations between departments sometimes suffer from blurred and ill-defined boundaries. It is therefore necessary to provide a concentrated effort in order to sustain good communication and beneficial working relationships. Finances and manpower are other areas subject to examination and each of these could probably provide a platform for discussion by themselves.

It will be some time before an accurate picture of the benefits or otherwise can be determined.

*Issues currently engaging the minds of asset managers in*

# HOBART

*For **Richard Davoren**, **Department of Education**, Tasmania, the issues are:*

### (1) Ageing Buildings and Over-Provision

Our 230 schools, 9 administrative buildings and 53 public libraries, have a high community profile but they are ageing and there are more of them than are needed for our current population growth rates. The combination of significant over-provision of schools in areas of reduced demand with the consequential maintenance and rehabilitation demands of ageing campuses that do not fully meet service delivery needs of the 1990s and beyond is one of the major issues that we are currently grappling with. Deferred maintenance is a by-product of not having sufficient funding to address many of these competing demands for capital and maintenance and is substantial in terms of the asset base. Buildings of the 60's do not meet many of the statutory requirements and building code of the present time and addressing the risks presented by these older structures, is a costly business.

### (2) Information Technology – and Increased School Security

The provision of information technology into these older schools also poses challenges as well as new capital demands. Tasmania has a high rate of property crime and this affects school sites as well. The introduction of computer hardware into schools has made schools an enhanced target for criminals. Schools have been traditionally community places and people see school grounds as places where they can associate in, play sport in and move freely around. This makes security difficult. Crime prevention was never designed into schools built in past times and adapting schools to comply with CPTED principles is not simple.

Some more detail on current asset management activities and issues can be found on the Tasmanian Education Department's website : http://www.tased.edu.au/facnet/

**Richard.Davoren@Central.tased.edu.au**

*For Brian **Edwards**, the newly appointed Manager Surveying and Asset Services with the **Hobart City Council**, the issues are*

### Quality Assurance and the Costs of Capital

Hobart CC is using the "Conquest" computer software as its core asset management tool and this being linked to its GIS. Comprehensive asset management plans are progressively being developed for key infrastructure groups and the Surveying and Asset Services Group are moving towards quality assurance certification.

An issue of immediate concern is reviewing (and defending) financial charges as a result of more reliable and relevant information being collected and used to better reflect the true condition of the assets and their residual useful lives.

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