



House of Commons
Committee of Public Accounts

**Contracting out public
services to the private
sector**

Forty-seventh Report of Session 2013–14

*Report, together with formal minutes, oral and
written evidence*

*Ordered by the House of Commons
to be printed 26 February 2014*

HC 777
[Incorporating HC 791, of Session, 2013-14]
Published on 14 March 2014
by authority of the House of Commons
London: The Stationery Office Limited
£13.50

Committee of Public Accounts

The Committee of Public Accounts is appointed by the House of Commons to examine “the accounts showing the appropriation of the sums granted by Parliament to meet the public expenditure, and of such other accounts laid before Parliament as the committee may think fit” (Standing Order No 148).

Current membership

Rt Hon Margaret Hodge (Labour, Barking) (Chair)
Mr Richard Bacon (Conservative, South Norfolk)
Stephen Barclay (Conservative, North East Cambridgeshire)
Guto Bebb (Conservative, Aberconwy)
Jackie Doyle-Price (Conservative, Thurrock)
Chris Heaton-Harris (Conservative, Daventry)
Meg Hillier (Labour, Hackney South and Shoreditch)
Mr Stewart Jackson (Conservative, Peterborough)
Fiona Mactaggart (Labour, Slough)
Austin Mitchell (Labour, Great Grimsby)
Nicky Morgan (Conservative, Loughborough)
Nick Smith (Labour, Blaenau Gwent)
Ian Swales (Liberal Democrats, Redcar)
Justin Tomlinson (Conservative, North Swindon)

Powers

Powers of the Committee of Public Accounts are set out in House of Commons Standing Orders, principally in SO No 148. These are available on the Internet via www.parliament.uk.

Publications

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the internet at www.parliament.uk/pac. A list of Reports of the Committee in the present Parliament is at the back of this volume. Additional written evidence may be published on the internet only.

Committee staff

The current staff of the Committee is Sarah Petit (Clerk), Claire Cozens (Committee Specialist), James McQuade (Senior Committee Assistant), Ian Blair and Jacqui Cooksey (Committee Assistants) and Janet Coull Trisic (Media Officer).

Contacts

All correspondence should be addressed to the Clerk, Committee of Public Accounts, House of Commons, 7 Millbank, London SW1P 3JA. The telephone number for general enquiries is 020 7219 5708; the Committee’s email address is pubaccom@parliament.uk

Contents

Report	<i>Page</i>
Summary	3
1 Five areas for improvement	5
Formal Minutes	12
Witnesses	13
List of printed written evidence	13
List of Reports from the Committee during the current Parliament	14

Summary

More and more public services are being contracted out to private and voluntary providers. Government spends £187 billion on goods and services with third parties each year, around half of which is estimated to be on contracting out services. Government retains responsibility for ensuring value for money and we, on behalf of the taxpayer, need to be able to follow the taxpayers' pound, wherever it is spent.

This report brings together evidence from two hearings on contracting out government services, which we held on the basis of reports by the National Audit Office (NAO).¹ In the first hearing, we heard from four major government suppliers: Atos, Capita, G4S and Serco. Between them, they held government contracts worth around £4 billion in 2012-13. In the second hearing, we took evidence from the Cabinet Office (which is responsible for how government manages its suppliers), the Department of Health, the Ministry of Defence and the Ministry of Justice.

Government is clearly failing to manage performance across the board, and to achieve the best for citizens out of the contracts into which they have entered. Government needs a far more professional and skilled approach to managing contracts and contractors, and contractors need to demonstrate the high standards of ethics expected in the conduct of public business, and be more transparent about their performance and costs. The public's trust in outsourcing has been undermined recently by the poor performance of G4S in supplying security guards for the Olympics, Capita's failure to deliver court translation services, issues with Atos's work capability assessments, misreporting of out of hours GP services by Serco, and most recently, the astonishing news that G4S and Serco had overcharged for years on electronic tagging contracts: these high profile failures illustrate contractors' failure to live up to standards expected and have exposed serious weaknesses in Government's capability in negotiating and managing private contracts on behalf of the taxpayer.

There is significant scope for government to improve its approach to contracting for public services. The Cabinet Office told us that there is a long way to go before government has the right commercial and financial skills to manage contracts and it needs to use the full range of powers at its disposal. For example, the Cabinet Office told us that only a third of contracts are on an open-book basis and, even then, departments rarely use the access provided and have a shortfall in the capability required to do so.

The contracting process at present excludes SMEs, and therefore the innovation which could be generated by a wider group of suppliers is not available to Government. So far, the contracting out of services has led to the evolution of privately-owned public monopolies, who largely, or in some cases wholly, rely on taxpayers' money for their income. The state is then constrained in finding alternatives where a big private company fails. We intend to return to this issue. The Government should also require Accounting Officers to take responsibility for and show leadership in relation to contract management. One of the

¹ C&AG's Reports, *The role of major contractors in the delivery of public services*, HC810, Session 2013-14; and *Managing government suppliers*, HC811, Session 2013-14, 12 November 2013.

consequences of devolving this role to relatively junior officials is they regard contract management as an exercise in catching people out, rather than working closely with contractors to improve the quality of services.

The four Government contractors we met all accepted they needed to be more open and held to public account. They accepted that open-book contracts should be the norm. They also accepted that the NAO should have access to all the relevant information associated with contracts with the public sector. And they were content that Freedom of Information provisions should apply to public sector contracts with their companies. Since the contractors confirmed that they would agree to these changes it appears that the barriers lie instead with government itself. The Cabinet Office told us that publishing information in full on large contracts such as the Work Programme may present a burden for suppliers, but that in principle this information should be made available.

We welcome the cooperation received from Atos, Capita, G4S and Serco, both in supplying the NAO with data for its reports and in giving us constructive and candid evidence for our hearing. That spirit of cooperation and openness needs to be sustained and apply to all private contractors that provide public services.

We are pleased that both the private contractors and government recognised the need for improvement: by government in its handling of contracts; and by the private sector contractors in recognising their responsibilities to parliament and to the taxpayer for the proper management of public service contracts. In this report, we set out five areas where the government and private contractors have fallen short in the past, and we make associated recommendations for improvement.

1 Five areas for improvement

Transparency: There needs to be far greater visibility to government, parliament and the public about suppliers' performance, costs, revenues and profits.

1. The spirit of cooperation and openness we saw from the four contractors we examined needs to read across to all private contractors who receive public funds.² Too often the government has used commercial confidentiality as an excuse to withhold information, often in response to Freedom of Information (FOI) requests from the public or MPs. However, the contractors we examined had fewer qualms about commercial sensitivity and recognised the public's right to more visibility over the use of the taxpayers' pound.³ We expect to see all government bodies that contract out functions and public services, and the contractors themselves, having transparency, not commercial sensitivity, as their default position.⁴ We did receive assurances from the Cabinet Office on the openness of significant government contracts, specifically agreeing that performance information on the Work Programme should be made public in full.⁵
2. The Cabinet Office also told us that only one-third of government contracts currently require the use of open-book accounting, and that, even where such provisions exist, they are rarely used.⁶ Departments have often lacked the ability to use open-book accounting, and they would need to improve their capability significantly to make this work in practice.⁷ The contractors we examined had no objection to open-book requirements being built into contracts, and it is surprising that such an 'easy-win' to improve transparency over vast sums of expenditure has not been implemented.⁸ Open-book accounting provisions need to be standard practice in government contracts and need to be used. Parliamentary scrutiny of private sector provision is also hindered by the NAO's access to companies being limited to examining individual contracts.⁹

2 HC 777-I, Qq 53-55, 238

3 HC 777-I, Qq 208-212

4 HC 777-I, Qq 24-27, 31, 209

5 HC 791-I Q31

6 HC 791-I, Qq 2-5

7 HC 791-I, Qq 2-53, 40

8 HC 777-I, Qq 10-13, 25, 27, 29, 44; HC 791-I, Qq 11-15, 30

9 HC 777-I, Qq 21, 26, 53, 55-56

Recommendations:

- **The Cabinet Office should:**
 - **mandate the use of open-book accounting for contracts above an agreed level of expenditure;**
 - **develop guidance for departments on how and when to use open-book accounting**
 - **explore how the FOI regime could be extended to cover contracts with private providers, including the scope for an FOI provision to be included in standard contract terms; and**
 - **Ensure that the Comptroller and Auditor General has adequate access rights to contractors.**
- **Neither the Cabinet Office nor departments should routinely use commercial confidentiality as a reason for withholding information about contracts with private providers. A clear explanation for any exceptions must be provided and the Cabinet Office should check that departments are treating disclosure as their default position; and**
- **The Cabinet Office should set out a plan for departments to publish routinely standard information on their contracts with private providers including, for example, contract duration, value and performance against key indicators.**

***Contract management and delivery:* Central government's management of private sector contracts has too often been very weak.**

3. Contracting-out can bring benefits to both citizens and to the taxpayer. For example, the Department for Work and Pensions has been able to make use of the economies of scale provided by Capita's established private sector customer contact centres, which previously serviced a number of other organisations.¹⁰ However, the benefits depend crucially on the government's ability to manage contracts well. There have been a number of fundamental weaknesses in how some government bodies have contracted for public services from private contractors.¹¹ Some departments do not adequately protect the taxpayer and citizens' interest in the writing of contracts. This was the case in the contract on GPs' out of hours services in Cornwall that this Committee examined. Some departments are not always sufficiently vigilant of contractors' operations and delivery of services to users.¹² For example, while it is scandalous that G4S and Serco overcharged the taxpayer tens of millions of pounds

10 C&AG report, The role of major contractors in the delivery of public services, Figure 4, HC810, Session 2013-14

11 HC 791-I, Qq 91-110

12 HC 777-I, Qq 29, 151, 157-158; HC791-I, Qq 15, 44, 131

for electronic tagging, it is shocking that the Ministry of Justice did not spot the overcharging for eight years.¹³

4. The rapid growth in public sector business by some contractors, often achieved through acquisitions, has in some cases outpaced their ability to keep tight controls over all aspects of their government funded business; and, in turn, government bodies have not done enough to gain assurance that contractors have adequate governance and internal controls.¹⁴ For example, the G4S Chief Executive admitted that they did not have the right controls in place on the electronic monitoring contract, and the Serco Chairman told us that they needed to build significantly on their controls in order to bring them up to an appropriate level.¹⁵
5. Government has a tendency to make managing contractors' performance overly complicated, and not always focused on the most important issues – we heard of one example where a department had put in place 150 performance indicators.¹⁶ Government needs to have information on contractors' performance and the way they manage public services across government. This includes user feedback, independent inspections and information on corporate social responsibility, including the company's approach to taxation. However, data collection comes at a cost and too often government has not demonstrated that it knows what it is asking for, or why. This leads to poor information and waste. Information needs to be focused, proportionate and relevant, coupled with performance indicators that are linked to appropriate penalties for failure and to rewards for excellence.¹⁷
6. Where contractors have failed to deliver, the penalties are sometimes not imposed and even where they are, have not always reflected the full cost to the taxpayer. For example, a series of failures by Capita in supplying translators to the court service was met with a fine of only £2,200. This does not come close to taking into account the cost to the criminal justice system and to individuals caused by their failure to deliver.¹⁸

Recommendations:

- **Cabinet Office should provide guidance to departments on how to ensure that contractors, of any size, have effective governance and internal controls over all aspects of their operations;**
- **Cabinet Office should provide guidance and support to ensure the terms of contracts properly protect both the taxpayers' interest and the service users' legitimate expectations.**

13 HC 777-I, Qq 47-48, 132-133, 207; HC791-I, Q123

14 HC 777-I, Qq 9, 51-52, 63-65; HC791-I, Qq 141-143

15 HC 777-I, Qq 51-52

16 HC 791-I, Q36

17 HC 777-I, Qq 35-38, 62-70, 81-82, 155, 172-188, 221-229

18 HC 777-I, Qq 65-67

- Cabinet Office should seek to standardise the information that government requests from contractors as far as possible and improve the consistency, accuracy and efficiency of information collection;
- Departments should periodically review and update the performance regime of their major contracts to ensure that they reward or penalise behaviour as appropriate;
- To encourage good performance, departments should look at the scope for more ways to share the savings from efficiency gains with contractors;
- Departments should ensure that the penalties imposed on contractors who fail to deliver reflect the full cost to the taxpayer; and
- Departments should make full use of their ability to take into account past performance on similar contracts when re-tendering or contracting for new services. Assessment of contractors' performance should also cover their corporate social responsibility policies and their record on corporate taxation.

Competition: There is not enough effective competition in the market for government business.

7. Some private sector providers have grown significantly in recent years, often through buying up competitors or other organisations in their supply chain—for example, Capita's purchase of the court interpreters' service.¹⁹ But the government has not analysed directly the implications on the operation of the marketplace, and on the delivery of public services.²⁰ Some public service markets, such as for private prisons, asylum accommodation or the Work Programme are now dominated by a small number of contractors, and the government is exposed to huge delivery and financial risks should one of these suppliers fail. At the very least, limited markets lack the competition required to ensure that taxpayers get the best deal.²¹ One way in which government can avoid becoming overly reliant on particular suppliers is ensuring that different parts of a service are provided by different companies. This was not true of the electronic monitoring contracts, where G4S and Serco provided both the service and the equipment.²²
8. Small and medium-sized enterprises (SMEs) are still hampered in their efforts to win government business by excessive bureaucracy and bidding costs.²³ We heard of one example in the Ministry of Justice where the procurement process took more than 18 months, and bidders were required to provide the equivalent of 12 A4 boxes of information.²⁴ It is even harder for them to compete when large scale providers have

19 HC 777-I, Qq 70, 91; HC 791-I, Qq 64, 66, 68-69, 76-79, 82, 135

20 HC 791-I, Q67

21 HC 777-I, Qq 63-68, 70, 82, 83, 91-112, 188, 191; HC 791-I, Qq 65-68

22 HC 791-I, Qq 67-69

23 HC 777-I, Qq 28-30, 152; HC 791-I, Qq 64, 70-72, 76, 135

24 HC 791-I, Q72

come to dominate a market, when contracts are unnecessarily long, or when contracts are extended when they should be re-tendered.²⁵ Furthermore, where SMEs are in the supply chain of larger firms—as is the case with the Work Programme – they have often found that the majority of profits stay with the major supplier and do not find their way down to smaller firms.²⁶ We are pleased that the Cabinet Office has recognised the need to change contracting habits and create a more competitive marketplace of providers.²⁷

Recommendations:

- **In the short term, departments should review contracts to ensure that, in the event of supplier failure, contingency plans are in place for continuity of services, and that government is protected financially. They should explore all options for amending existing contracts where necessary;**
- **In the longer term, the Cabinet Office and departments should do more to encourage diverse markets. For example, departments could split up contracts and be required to set out specific actions to encourage SMEs and new entrants in particular markets, either as primary bidders, sub-contractors or part of consortia; and**
- **Departments should increase competitive pressure by reducing contract duration and extending contracts only by exception—balancing the need for stability and incentives for contractors to invest in improvement with the scope for savings from increased competition.**

***Capability:* Government does not currently have the expertise to extract the greatest value from contracting to private providers.**

9. The Cabinet Office told us that government has a long way to go before it has the skills required to manage contracts properly.²⁸ This is a concern, given the speed at which some departments—such as the Ministry of Justice—are going ahead with outsourcing, despite a poor track record.²⁹ We have not seen enough ownership or oversight of contracts at Accounting Officer and board level in departments.³⁰ Beneath that, there is a longstanding problem of insufficient investment in staff with contract management skills. This is illustrated, for example, by recent problems with contracts for electronic tagging and out-of-hours GP services.³¹ The Cabinet Office recognises the skills gap in departments and agencies and told us about plans to

25 HC 777-I Qq 91-98, 136-144; C&AG report, The role of major contractors in the delivery of public services, Figure 6, Figure 10, HC810, Session 2013-14

26 HC 791-I, Q82

27 HC 777-I, Qq 24, 64, 81-85; HC 791-I, Q 77

28 HC 791-I, Q 42, 44, 45

29 HC 791-I, Qq 132-133

30 HC 777-I, Qq 28, 51, 151, 157-158; HC 791-I, Qq 15, 44-45, 131

31 HC 777-I, Q 112; HC 791-I, Qq 136, 140, 143

recruit people with the relevant skills and commercial expertise.³² It remains to be seen whether the Cabinet Office can deliver on its ambitious agenda for improving skills across government, and secure the resources necessary to do so. In our view, investment in the right people with the right commercial skills is essential if the Government is to achieve the objectives of contracting out.³³

10. To its credit, the Cabinet Office has also recognised that government needs to act as one customer in its relationship with major suppliers, who often have contracts with several different government bodies.³⁴ It has introduced ‘Crown Representatives’, who are senior officials responsible for leading the government’s relationships with a portfolio of suppliers. This is a welcome step, but the Crown Representatives are under-resourced and contractors tell us that their regular points of contact in departments are still not sufficiently senior, skilled, or empowered to make quick decisions.³⁵

Recommendations:

- **The Cabinet Office and departments should ensure that there is appropriate Accounting Officer and board level engagement in all major contracting decisions;**
- **The Cabinet Office and departments should invest in developing experience and expertise in commercial issues and contract management;**
- **The Cabinet Office should explicitly require departments to ensure that those who are responsible for day-to-day contract management have sufficient authority, commercial skills and experience. This includes having the expertise to put open-book accounting into practice; and**
- **The Cabinet Office should strengthen the Crown Representative initiative, ensuring sufficient coverage across government bodies and major suppliers, providing them with the time and support necessary.**

Public service standards: Contractors have not consistently demonstrated the high ethical standards expected in the conduct of public business.

11. For a number of years, Serco and G4S charged the Ministry of Justice for services they were not providing. Serco’s Chairman has at least admitted that this was ‘ethically wrong’ and G4S’s Chief Executive admitted to the company’s ‘flawed judgement’.³⁶ The four contractors we examined all have whistleblowing policies in place. However, although legislation has enabled contractors to nominate someone

32 HC 791-I, Qq 22, 44-45, 131, 134, 139

33 HC 791-I, Q 134

34 HC 791-I, Qq 36, 42, 48-50

35 HC 777-I, Qq 149, 163-165; HC 791-I, Qq 45, 63, 78, 142

36 HC 777-I, Qq 115, 117-118, 124, 133

in the contracting department as a person to whom whistleblowers can make authorised disclosures, none have done so.³⁷

Recommendations:

- **Departments should include a standard term in contracts requiring suppliers to have whistleblowing policies in place. This should require contractors to nominate designated officials within departments to receive disclosures from whistleblowers;**
- **The Cabinet Office needs to be clearer with firms which seek to win government contracts that they are expected to behave with the same standards of honesty, integrity and fairness that apply to the public sector itself. It should set specific expectations which include transparency, the treatment of service users and employees, and ethics; and**
- **The Cabinet Office and government bodies should ensure that government's expectations are then built into standard contract terms.**

37 C&AG's Report, The role of major contractors in the delivery of public services, paras 3.14-3.15

Formal Minutes

Wednesday 26 February 2014

Members present:

Mrs Margaret Hodge, in the Chair

Richard Bacon
Jackie Doyle-Price
Chris Heaton-Harris
Meg Hillier

Fiona Mactaggart
Austin Mitchell
Nick Smith
Justin Tomlinson

Draft Report (*Contracting out public services to the private sector*), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 11 read and agreed to.

Conclusions and recommendations agreed to.

Summary agreed to.

Resolved, That the Report be the Forty-seventh Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

Written evidence was ordered to be reported to the House for printing with the Report.

[Adjourned till Monday 3 March at 3.00 pm]

Witnesses

Wednesday 20 November 2013

Page

Ashley Almanza, Chief Executive, G4S, **Paul Pindar**, Chief Executive, Capita, **Alistair Lyons**, Chairman, Serco and **Ursula Morgenstern**, Regional CEO UK and Ireland, Atos

Ev 1

Monday 25 November 2013

Stephen Kelly, Chief Operating Officer, UK Government, **Bill Crowthers**, Chief Procurement Officer, UK Government, **Les Mosco**, Commercial Director, Ministry of Defence, **Vincent Godfrey**, Director of Procurement, Ministry of Justice and **Richard Douglas**, Director General of Finance and the NHS, Department of Health

Ev 28

List of printed written evidence

1	Serco	Ev 48
2	Capita	Ev 48
3	Atos	Ev 50
4	G4S	Ev 51
5	Cabinet Office	Ev 51
6	Ministry of Defence	Ev 52

List of Reports from the Committee during the current Parliament

The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

Session 2013–14

First Report	Ministry of Defence: Equipment Plan 2012-2022 and Major Projects Report 2012	HC 53
Second Report	Early Action: landscape review	HC 133
Third Report	Department for Communities and Local Government: Financial sustainability of local authorities	HC 134
Fourth Report	HM Revenue & Customs: tax credits error and fraud	HC 135
Fifth Report	Department for Work and Pensions: Responding to change in jobcentres	HC 136
Sixth Report	Cabinet Office: Improving government procurement and the impact of government's ICT savings initiative	HC 137
Seventh Report	Charity Commission: the Cup Trust and tax avoidance	HC 138
Eighth Report	Regulating Consumer Credit	HC 165
Ninth Report	Tax Avoidance – Google	HC 112
Tenth Report	Serious Fraud Office – redundancy and severance arrangements	HC 360
Eleventh Report	Department of Health: managing hospital consultants	HC 358
Twelfth Report	Department for Education: Capital funding for new school places	HC 359
Thirteenth Report	Civil Service Reform	HC 473
Fourteenth Report	Integration across government and Whole-Place Community Budgets	HC 472
Fifteenth Report	The provision of the out-of-hours GP service in Cornwall	HC 471
Sixteenth Report	FiRe Control	HC 110
Seventeenth Report	Administering the Equitable Life Payment Scheme	HC 111
Eighteenth Report	Carrier Strike: the 2012 reversion decision	HC 113
Nineteenth Report	The dismantled National Programme for IT in the NHS	HC 294
Twentieth Report	The BBC's move to Salford	HC 293
Twenty-first Report	Police Procurement	HC 115
Twenty-second Report	High Speed 2: a review of early programme preparation	HC 478
Twenty-third Report	HM Revenue & Customs: Progress in tackling tobacco smuggling	HC 297
Twenty-fourth Report	The rural broadband programme	HC 474
Twenty-fifth Report	The Duchy of Cornwall	HC 475
Twenty-sixth Report	Progress in delivering the Thameslink programme	HC 296
Twenty-seventh Report	Charges for customer telephone lines	HC 617
Twenty-eighth Report	The fight against Malaria	HC 618

Twenty-ninth Report	The New Homes Bonus	HC 114
Thirtieth Report	Universal Credit: early progress	HC 619
Thirty-first Report	The Border Force: securing the border	HC 663
Thirty-second Report	Whole of Government Accounts 2011-12	HC 667
Thirty-third Report	BBC severance packages	HC 476
Thirty-fourth Report	HMRC Tax Collection: Annual Report & Accounts 2012-13	HC 666
Thirty-fifth Report	Access to clinical trial information and the Stockpiling of Tamiflu	HC 295
Thirty-sixth Report	Confidentiality clauses and special severance payments	HC 477
Thirty-seventh Report	Supporting UK exporters overseas	HC 709
Thirty-eighth Report	Improving access to finance from small and medium-sized enterprises	HC 775
Thirty-ninth Report	The Sovereign Grant	HC 665
Fortieth Report	Maternity services in England	HC 776
Forty-first Report	Gift Aid and other reliefs on charitable donations	HC 835
Forty-second Report	The Charity Commission	HC 792
Forty-third Report	Progress at Sellafield	HC 708
Forty-fourth Report	Student loan repayments	HC 886
Forty-fifth Report	Excess votes 2012-13	HC 1068
Forty-sixth Report	Emergency admissions to hospital	HC 885

Oral evidence

Taken before the Committee of Public Accounts on Wednesday 20 November 2013

Members present:

Margaret Hodge (Chair)

Mr Richard Bacon
Stephen Barclay
Guto Bebb
Jackie Doyle-Price
Chris Heaton-Harris
Meg Hillier

Mr Stewart Jackson
Fiona Mactaggart
Austin Mitchell
Nick Smith
Ian Swales
Justin Tomlinson

Amyas Morse, Comptroller and Auditor General, **Gabrielle Cohen**, Assistant Auditor General, **Keith Davis**, Director, National Audit Office, and **Marius Gallaher**, Alternate Treasury Officer of Accounts, were in attendance.

REPORTS BY THE COMPTROLLER AND AUDITOR GENERAL

The role of major contractors in the delivery of public services (HC 810)

The Ministry of Justice's electronic monitoring contracts (HC 737)

Examination of Witnesses

Witnesses: **Ashley Almanza**, Chief Executive, G4S, **Paul Pindar**, Chief Executive, Capita, **Alastair Lyons**, Chairman, Serco, and **Ursula Morgenstern**, Regional CEO UK and Ireland, Atos, *gave evidence*.

Q1 Chair: Welcome and thank you for coming. Clearly we have a lot to get through today, so the Committee would be really grateful if you could keep answers pithy, short and direct. Then we will have a constructive session.

I will start by saying that this is not a session in which we are trying to pass a verdict on whether it is good or bad for Government to contract out public services. There will be a variety of views around the table. We are not here to look at that at all. What we are about is starting to ensure that there is proper accountability for the taxpayer's pound, and starting to ask some value-for-money questions about private contractors delivering public services, particularly in an environment where you are going to play a growing role in the delivery of those services. I see this as the first in a number of engagements. It is about beginning to understand the landscape and the key issues we all need to grapple with.

I will ask you first to give us briefly the extent of the public services you cover. Can you describe the range of public services for which you have contracts in the UK? Starting with you, Paul, will you go through as quickly as you can on that one? Just give us the range so that everybody understands.

Paul Pindar: Thank you for the introduction. To give you some metrics to put it into perspective, the total amount of money we receive from the UK public sector is in the region of £1.1 billion. Around £500 million of that is from central Government. We do a very broad span of white-collar outsourcing activities, ranging from running IT operations, HR functions, finance functions and essentially anything that replicates the white-collar element of the back office

of a public sector organisation. Those would be the areas we would be interested in operating in.

Q2 Chair: Give us about eight or 10 examples. I know them because I have bothered to look it up. Just go through.

Paul Pindar: Okay. I will give you a few things. We run a contract for the Department for Work and Pensions that is called Cipher,¹ where we are responsible and accountable for managing all the contractors that operate within DWP. The benefit that brings to DWP is that we can get harmonisation of conditions from the contractors. By aggregating them we can help save DWP a lot of money and, indeed, we have. We have saved them something like £25 million.

Q3 Chair: Just name them. I am trying to get a feel for the areas you cover, the sort of service.

Paul Pindar: We will be working in the Department of Energy and Climate Change and will be helping with the project managing of the roll-out of the smart metering campaign over the next six years. We work with people such as the Home Office. For example, we are running the disclosure and barring service. We run more mundane or basic activities such as payroll operations for people such as MyCSP. Will that do?

Q4 Chair: Good, brilliant. Mr Almanza.

¹ Note by witness: Please note that while originally let by DWP, the Cipher contract as detailed in the NAO study links these revenues exclusively to DWP. In practice, nearly all departments use and pay for services under the framework contract to access the savings and other benefits.

Ashley Almanza: We have about £700 million of revenue from Government. Most of that—about £570 million—is from central Government. Our biggest customer is the Ministry of Justice, where we provide electronic tagging, prisons, secure facilities. We also provide secure facilities management in other settings such as courts and tribunals around the country. Most of our work is focused in the area of security as you would expect. We also provide services for DWP such as facilities management but also on the welfare-to-work programme.

Q5 Chair: Thank you. Mr Lyons.

Alastair Lyons: At Serco we have around £1.8 billion of UK public sector turnover, of which our central Government turnover is about £1.2 billion. We focus on areas of justice and defence, transport and health services. Within justice, we run prisons, we do electronic tagging, we help with the Youth Justice Board, we run immigration and detention centres. In defence, we run some army and air force bases. We do RAF Cranwell. We are a third share in the Atomic Weapons Establishment. On transport, we run docklands light railway and we are responsible for Boris bikes in London. In health, we work with a number of community health care areas.

Q6 Chair: And Ms Morgenstern.

Ursula Morgenstern: At Atos, we have about £700 million from central Government. About two thirds of that will be in the technology space and about a third in the business process outsourcing area. The two contracts that have been covered are the DWP's benefits assessments and the back office operations for National Savings and Investments. In the technology space, the biggest client is the Ministry of Justice, where we run the desk jobs and IT infrastructure. A lot of the work for the Department for Transport, the Vehicle and Operator Services Agency and the Highways Agency is again running the technology. We have other contracts with the Department for Culture, Media and Sport, the Department for International Development and the Foreign and Commonwealth Office, mostly in the technology space.

Q7 Chair: Thank you. I now want to ask another question and again a shortish answer would be very helpful. In your view, with the masses of contracts that you have, what should Government do to become a better client? I will start with you, Mr Almanza.

Ashley Almanza: Principally, Government should continue to do what they have been doing. From our vantage point, engagement with Government has become more formal and procurement with the procurement arm of Government—

Q8 Chair: Do you think it is working well?

Ashley Almanza: On the whole, I think it is. There are some obvious exceptions.

Q9 Chair: What I am interested in—and one of the reasons why we are here—is that your business with the public sector has massively grown, by about 500% in the last decade, give or take. It is a massive,

massive expansion and with present Government policy, that is likely to increase, so it really matters to the taxpayer that we get best value for that. There are a growing number of examples—no doubt we will come to them in the hearing—where there is a question mark over whether all of you provide best value. What should we be doing? I am getting you to put the onus back on Government, not on us the Committee. What should Government be doing to eke better value so the taxpayer does not get ripped off? A real, honest response to that would be very helpful.

Ashley Almanza: Would you like me to begin?

Chair: Yes, keep going, apart from telling us that we are all wonderful, which we know.

Ashley Almanza: Government have increased the level of competition to supply.

Q10 Chair: Where?

Ashley Almanza: We are happy to talk about that. From our vantage point, competition has increased. Competition is ferocious. The relationship is more formal and procurement has become a lot more sophisticated. The contracts include much greater rigour around performance indicators and so on. So continuing to increase the capability within Government to let and manage contracts is the right thing to do and I would expect to see more of that.

Alastair Lyons: What Government have begun doing, particularly over the last few years, is to pull together the various parts of Government so that there is a single interface at Cabinet Office between Government and the supplier. There is then a point in Government that understands the whole of the relationship with that supplier, across a multitude of Departments. That leads to a more informed customer and therefore a more effective customer. There should be continuation of transparency: requiring transparency from ourselves as suppliers to Government, so that there is a continuation of the move to open-book accounting and a much greater dialogue between Government and ourselves as the supplier, across all levels. For example, we are now inviting Government to appoint a director to the supervisory board of the new UK central government division, which we are forming.

Equally we would like departmental forums, where we sit down with Government, with full disclosure of our key performance indicators, so that they as a customer are as informed as we are about what is going on with our contracts.

Q11 Chair: A totally open-book contract, including financial information on all your contracts?

Alastair Lyons: Yes. We have already had 80% of our contracts on open book, as was in the NAO Report.

Q12 Chair: You have very few, Mr Almanza.

Ashley Almanza: According to the data here and the way we respond to the question, that would seem to be the case. On the other hand, you will have seen also in the NAO Report that we provided all the information that was asked of us on those contracts, whether or not it was open-book and like Mr Lyons we would have no problem.

20 November 2013 **G45, Capita, Serco and Atos**

Q13 Chair: You would have no problem with total open-book contracts?

Paul Pindar: No, we have no problem whatsoever. I don't know if you want to go back to your first question.

Q14 Chair: Actually, to be fair, I was going to go to Ms Morgenstern first and then come back to you on that. Sorry—I interrupted you, Mr Lyons. Was there anything else you wanted to add there?

Alastair Lyons: No, that's fine.

Ursula Morgenstern: Coming back to the original question you asked—how can Government be a better client?—from my perspective there is still a variety of skills in the Departments. I think what would be helpful would be, how can you encourage sharing of best practice. There are some Departments that are very good in contract management or in the procurement process, and how you share that best practice more effectively across Departments would be, I think, something to investigate. In looking at the Report, one of the areas that I was also looking at is how can you, for example, learn from local government into central Government. If you are looking at what is happening in central Government at the moment, there is increased business process outsourcing, which has already happened in the local government space. How can you actually learn from local Government into central Government?

Q15 Chair: Where is the best for Atos?

Ursula Morgenstern: For us, the best client, who has proven to be very good in the sense of partnership, but is no means soft, is actually National Savings and Investments. They ran a very strong re-procurement with strong terms and conditions which I might be able to refer to later on again, but on the other hand it is a partnership and when problems occur, there is joint working together to solve the issue for the end client. In a lot of cases, of course, while the Department is our direct client, it is delivering to the British taxpayer and sometimes it also includes other Departments. Again how that can be improved is one of the areas, from my experience, where best practice would be welcome.

Q16 Mr Bacon: You said that there is a variety of skills in the Departments. One might take that to mean that there are some people who can swim and some who can dance, but I don't think that is what you meant. Did you mean that there is a variety of levels of competence?

Ursula Morgenstern: Yes, thank you very much for correcting me.

Q17 Mr Bacon: There is high competence and low competence. Is that what you were saying?

Ursula Morgenstern: Yes. There are people who have high skill levels and others where, due to the history of the Departments, the skill levels might not be—people might not be as experienced from a commercial contract management perspective.

Q18 Mr Bacon: Have you ever turned down a contract or the offer of a contract because you thought the client side was not skilled enough?

Ursula Morgenstern: With hindsight—

Q19 Mr Bacon: No, I mean at the time. I don't mean afterwards thinking, "Why on earth did we do this?"

Ursula Morgenstern: We will look at the terms and conditions and—

Q20 Mr Bacon: So you are always prepared to take the money?

Ursula Morgenstern: No.

Q21 Mr Bacon: So you have turned down something?

Ursula Morgenstern: We will not bid for work, we will be selective in bidding because we will assess whether we can do the work.

Q22 Mr Bacon: My question was, have you ever turned down work because you thought the client side was not skilled enough?

Ursula Morgenstern: It is not possible to just turn up. We have to go through a formal procurement process so the moment we will make that decision is when we start to bid. As Government procurement can be quite dear, we will make that selection early on in the bid process.

Q23 Chair: Has anybody turned down a job?

Paul Pindar: Yes.

Q24 Chair: What did you turn down?

Paul Pindar: We turned down a local government job, not a central Government job. Actually it wasn't because we didn't think they were competent, it was because a 10-year contract is a long-term relationship. I would completely agree with Ursula's comments. It needs to be a happy relationship, and we were concerned that the tone of the relationship was wrong. We want to work in partnership where people actually get on in a harmonious way with a common objective. We turned down a £107 million contract when we were the preferred bidder because we did not believe that the 10-year relationship was going to be happy.

Q25 Chair: Finally, open-book contracts.

Ursula Morgenstern: I have no problems with transparency. We provide our information regularly to the Cabinet Office. One of the questions I have is—how do you ensure transparency with the whole competitive field? This is just four of us and as we have heard at the beginning, two thirds of our business is in the technology space, so my question is, no problem with transparency, but how do you ensure it is a level playing field for all of us?

Q26 Chair: Well that is for Government to ensure. I am going to come to you, Mr Pindar. Does anybody object to having the NAO access the accounts that you have—the contracts that you have, so that it can look from the point of view of the taxpayer to see that the

taxpayer's interests are protected and we get value for money? Do any of you object to that?

Paul Pindar indicated dissent.

Ashley Almanza indicated dissent.

Alastair Lyons indicated dissent.

Q27 Chair: Right. We might make progress on this. At the moment, the Prime Minister has not conceded it to us; he might now change his mind. Mr Pindar, you can answer. Then I have a list: Justin, Austin, Ian, Meg, Nick.

Paul Pindar: I was going to tackle your question in two ways. You very kindly tackled the question of what Government could do better and I was also going to say, in the spirit of partnership, what we could do better.

In terms of the list of the three things I would be requiring if I were in your shoes, I think you should require open-book accounting. The simple principle for that is that if you are a contractor—as I believe all of us are—that wants to do a good job and make a reasonable return but not to profiteer, there is no conceivable reason why you would not agree to open-book accounting.

The second thing that I think you should think about is having the power to put third-party auditors in on any contract at any time. Again, if you have nothing to hide, why wouldn't you be prepared to do that? Certainly from Capita's perspective, we would be quite happy to do that. One of the key things we need to address at the moment is the matter of trust. As we collectively know, probably there are issues where trust has been breached and anything we can do to rebuild that would be helpful.

There is a third thing that we can do as an industry, which again from Capita's perspective we would be very happy to do and is a far more imaginative and creative solution to the issue of companies making too much money. I get concerned when I hear people having a debate about the amount of margin that businesses like us make, because actually our margin is a by-product of efficiency. What you do not want to do is say, "Well, we don't want you earning a margin over x ," because all you are doing is disincentivising us from generating efficiency. The better way of rewarding it is to say, "Let's agree what is a reasonable margin and then, above and beyond that, let's share that margin with the client." Then, what you immediately do is create a continuity of interest between Government and ourselves that means that the more efficiency we can generate, the more the taxpayer will benefit. We have done that now in a number of instances.

Q28 Chair: Where have you done that?

Paul Pindar: We have done that, for example, at Birmingham city council. We have also done it with the BBC on TV Licensing, where we have driven out huge efficiencies in that operation and we have done that in tandem with the client. Those are the three things that I was going to list that we can do with Government to make their lives easier.

I think there are things that Government could do for us. Again, one of the themes that comes out of what I thought was a superb Report from the NAO was the

theme of trying to encourage more SMEs to come into our market, because the market is much narrower than it ought to be in reality. One of the things that we need to do for SMEs is to make life easier for them. That means that we need to shorten the procurement process, make it simpler and make it cheaper. Anything we can do around the procurement process would help.

Richard Bacon made a comment about the level of competence. I would probably address it in a different way; that is to say, I do not think we have senior enough people involved in the procurement process on the Government side. We are actually putting a lot of people on the task, but they tend to be too junior. I think Government would score heavily if they assigned more senior people.

The third point I was going to make, which is a cultural point and a hard one to do, is that we need to create an environment within the employment of civil servants where we instil confidence in taking a risk and reduce the fear of taking a risk. Some of these things are complex arrangements where it is possible to save the taxpayer a lot of money, but sometimes things go wrong. We have had examples of where things go wrong. A great example is Applied Language Solutions: the language service for the Ministry of Justice. I have actually got a lot of respect for the Ministry of Justice taking the decision they did, because they have saved the taxpayer a lot of money, but there is clearly fear that when things go wrong, that will prejudice against their career. I think we need to find—

Q29 Chair: I would quarrel with your thinking that they saved money. They have not given us a proper calculation that looks at the extra money we have had to spend on services when interpreters were not provided.

Paul Pindar: That was point three.

Chair: There has not been a calculation of that figure and until we get that, we do not know. They might just have managed their staff better, including their interpreters, and that might just have saved money.

Paul Pindar: Point four: I understand why Francis Maude did it, but when the coalition came into power, one of the first things they did, because they were trying to shock the system into saving money, was a blanket ban on consultants. I completely understand the psychology behind that, because at that time the UK balance sheet was in a pretty awful state. I think we need to release that a little bit, because the thing that consultants really provide, apart from confidence, is expertise. Therefore, without spending very much money, more initiatives could get under way just by selective use of consultants. I think the blanket ban idea should now be released and we should be a little bit more selective.

The fifth thing I was going to say—again this is a kind of plea for my industry as a whole—is about requests for information. Our business serves nine sectors and the sector that asks for more information than anybody by an absolute mile is central Government. We don't mind providing information as long as it is relevant and has a value. But it is very expensive to produce lots of information and one of the reasons

20 November 2013 G45, Capita, Serco and Atos

why SMEs will not engage with central Government is just the sheer cost of doing so. Again, we would ask clients to be very thoughtful about what they ask for. We will be open book. We will be helpful, but please don't ask for things that have no value.

Chair: Now I have a list of Committee members who want to ask questions. I am going to keep questions short and then come back again later.

Q30 Justin Tomlinson: I spent 10 years as a local authority councillor. The drive from the last Government was for us to get as many services as possible out into the private sector to drive through efficiencies. I want you to comment on this and then I have a suggestion as to how this could be addressed and I want you to tell me whether I am barking up the wrong tree.

The challenge is that you are all experts at doing these bespoke, one-off contracts. You arrive at the table with a reasonable knowledge of what you need to do. It was always a one-off stand-alone for a local authority with no expertise. They would have an officer, who would often not necessarily be equipped or experienced enough to do this and all too often would not last the process. So you would get halfway through the contract negotiations and then they would go off to be paid more money somewhere else. Then you had a fresh set of eyes who did not really know all those things. Therefore local authorities would often make mistakes and they can be very expensive, inefficient mistakes.

First, is that typical? Secondly, I get the point about consultants. It always surprised me that the Government did not have a team of experts that, in effect, audited and supported local authorities and other organisations to make sure they were doing the right thing. Each local authority was doing maybe one or two of those for the first and only time. Yet if there was the pooled talent, centrally, seeing what was working in different areas, I think that could have made a huge difference.

Alastair Lyons: Just picking up one of your points, I think there is a duty upon us, as providers to the public sector, to be transparent in all respects. That transparency includes if we are, either going through a bid process or during the contract, coming across something where clearly it does not appear to be well understood by the government purchaser on the other side, then we have a responsibility, ethically, to make that clear to the government purchaser at the appropriate level of seniority. A particular example here would be change notices, where you have bid a contract, you have won the contract, you are in a contract for a period, but something needs to change and therefore you are, for that purpose, a monopoly supplier. So I think there is a responsibility for us to provide that transparency, which then eases that issue.

Q31 Justin Tomlinson: But my initial point was this: is there the expertise, particularly in local authorities where they are perhaps only doing one or two contracts, and is there consistency—are those key officers who are doing the contract negotiations there throughout the process? If the answer is no, should not the Government perhaps have that team of experts

who can come and say, "Well, collectively we have had sight of 500"—or whatever—"of these local authority contracts"? I get transparency, but I ran a business, and when you are doing a deal, it is a meeting of equal minds and you will always then come up with a fair deal.

I don't blame you because you are experts in your area, because this is what you do and this is the purpose of what you do, whereas these local authorities are doing one or two contracts and they are coming to it fresh. I have a feeling that we were not the only authority where the key officers changed and we were not empowered.

Paul Pindar: I have to say that our experience has been better than that. In the vast majority of instances we felt that the officers negotiating on a local government side a) had been pretty competent; b) have lived through the process of the negotiation, and c), very importantly, have lived with it thereafter. My only nervousness about your suggestion is this. I can understand the appeal of bringing in an outside group of experts to advise, but the trouble with that is that they then have all the embedded knowledge in their head and then disappear somewhere else. The advantage of having a local government officer to do it is, 1) they have the accountability of living with the decision, and 2) they have that embedded knowledge. I actually think local government, as a rule, is a pretty good procurer.

Fiona Mactaggart: Really?

Paul Pindar: Yes, probably, because they have been doing it since 1988 through compulsory competitive tendering. They are more experienced. They drive a harder bargain.

Q32 Mr Bacon: Is local government better at sharing best practice than central Government?

Paul Pindar: Again, the view would probably be yes. One of the reasons for that is because local government is a more homogeneous body. There are 400 local authorities, and although they all view themselves as being different, a lot of them do kind of the same things and there is a network where they share. If you look at central Government, where there are 20-odd very different bodies, there is less sharing.

Chair: We will stick to transparency before we move on because I think it is a big issue.

Q33 Meg Hillier: You talk about transparency and open-book accounting with the client, in this case the Government Department or local authority. I was very interested that you, Ms Morgenstern, talked about the British taxpayer being the ultimate client and there are a lot of users that you are serving.

Ursula Morgenstern: Yes.

Q34 Meg Hillier: I remember—it is perhaps a bit unfair to raise this—the housing benefit issues in London. You smile with recognition but it was not much fun for the people involved. I recognise that there were problems on both sides; there was not a smart client, but providers were not doing a good job there either. That was a fiasco and there was no openness there at all.

Paul Pindar: It was 15 years ago.

Q35 Meg Hillier: I know, but I am using it as an example because we all live with the scars of it. The ultimate consumer did not really know what was going on then; it was complete confusion. Is that better now? I do not think it is generally better, but what could be done to make Government procure you so that you are more open with the ultimate client? Or should it be Government that is being more open?

Paul Pindar: I can't resist responding to that on the basis that you raised our sins of 15 years ago. Point one is that your point is fair: point two is that everyone in this industry matures over time. The way that the industry as a whole has matured means that people have different practices.

Chair: Okay, let's stick to the transparency. I accept that it is 15 years ago, but I think we probably all have more recent examples.

Q36 Meg Hillier: My point is about the response to the client, the taxpayer.

Paul Pindar: The simple—

Chair: Can I bring in Ms Morgenstern, because she has not had a chance on this one? Just to divvy it up a bit.

Ursula Morgenstern: I think that the Department actually need to sit down at the beginning, or even throughout the contract, and think through what they want to say. We normally give the information to the Department and if that is clear from the very beginning, you can start to collect the data. Sometimes, to work it backwards is difficult if it has not been collected. All of us will give the information as defined and required by the client—and we often give more—and then it is really the Department which can decide how they will publish it. That thinking needs to take place at the very beginning.

Coming back to the question that was raised regarding how you can learn from a procurement, you often need to get in early before the solution is designed and before the procurement goes out. In the private sector, if you have a chance to go in early and help to design a solution, then you can use repetitive components. That will make it easier to deliver and cheaper to buy. That is early on in the procurement and that is where the Government need to really think through what they need and what they want from this client.

Q37 Nick Smith: I just want to pick up on Mr Almanza's commentary. When asked about the Government as a client, you pretty much gave a "steady as she goes" response. I wondered if you thought that the Ministry of Justice's capacity was good to effectively monitor your companies' contracts?

Ashley Almanza: To clarify my response, what I was trying to say was that the trend that you see in the way that the Government are managing contracts is, in my view, a positive trend to take. As Mr Pindar commented, this is an evolutionary process and the contracts that we are entering into today are vastly different to the early contracts. There is much greater granularity around performance, there are regular reviews of performance, including by the Ministry of Justice, as you mentioned.

To go to Ms Hillier's comment, it is in the hands of the client, the customer. When the contract is let it is completely at the option of the customer to say, "This is the information that we will require on a regular basis. These are the incentives for out-performing and these are the penalties for failing to perform."

Q38 Chair: I think we want to come back to the tagging contract; we have a separate paper on that and I was going to come to it.

Ashley Almanza: I was talking more generally.

Chair: Yes, but I think the tagging contract gives a bit of a lie to what you have just said. Let us stick to transparency if we can. Richard.

Mr Bacon: Thank you, because I would otherwise immediately respond to something that was said that reminded me of another of Capita's sins from 12 years ago.

Chair: Don't.

Q39 Mr Bacon: I won't.

I was listening to what Mr Pindar said, and to what Mr Lyons said a minute ago about openness. Mr Pindar said that there should be "third-party auditors...on any contract at any time"—it is a "matter of trust". There are issues around that, and given that some of you have criminal investigations pending against people because of the activities of some of your employees, that is not surprising. Mr Lyons said that providers to the public sector have a "duty...to be transparent in all respects." The way you say that sounds so encouraging that one might be forgiven for thinking that we had already reached the broad sunlit uplands where things are now much better than they used to be and we can all sit back and relax.

But I was looking through PwC's "Forensic review of the reported performance information of the Out of Hours service provided by Serco Group plc" to the Cornwall and Isles of Scilly primary care trust. We as a Committee got it only yesterday afternoon. PricewaterhouseCoopers finished the work on it back in April and it was sent to the NHS in September, so it has been knocking around somewhere for almost two months, but not with us. I have now just seen—we were sent this yesterday—Serco's rebuttal of the areas where PwC says it was not given full access. There is an argument going on here, in these two documents, about whether or not you have been transparent in all respects, which, if you were being transparent in all respects, manifestly could not be taking place. So you are not there yet, are you, Mr Lyons?

Alastair Lyons: I think as far as Cornwall is concerned, the forensic report relates to data from 12 months ago. A huge amount has been done on Cornwall since then—indeed, since your own Committee had a hearing on Cornwall earlier this year. As a company, we were deeply saddened and very sorry for what went on in Cornwall; it should never have happened, and we have been focused on actually changing those circumstances in Cornwall so that now we are delivering the required standards of care, we have required standards of staffing, as were shown by the Care Quality Commission in July—

20 November 2013 **G45, Capita, Serco and Atos**

Q40 Mr Bacon: May I stop you? That is all good stuff—all motherhood and apple pie—but the question is about transparency. You said that there is a duty to be transparent in all respects. In this report, dated September 2013—although yes, looking at information from 2012—PricewaterhouseCoopers said: “We would have expected a more extensive email review exercise to have been conducted to determine who within Serco knew of the misreporting at the time, other than the employees directly responsible. We would also have expected more detailed records to be kept of the investigative work undertaken.” That does not sound to me like a forensic reviewer that was able to do all of its job, because it was not able to get access to all the information.

I notice that in your reply, one of the arguments you pray in aid is patient confidentiality, but surely to goodness, when you are dealing with a forensic reviewer that is inside the curtain, it does not necessarily follow that everything the forensic reviewer looks at will be exposed to the light of the whole world, but you have to be able to show the forensic reviewer everything, don’t you? As Mr Pindar said, ultimately this is a matter of trust. There are various companies, like yours and others, that have, to a considerable extent, undermined by their own actions taxpayers’ trust in them, so you have got to work very hard to sort this. This does not tell me that you have got there yet.

Alastair Lyons: The rebuttal which we have put in is not a rebuttal denying the statements that PwC have made; it is with regard to certain specific issues which they have raised. As far as we were concerned, we were prepared to be totally open with regard to e-mails and information. We are, though, within the bounds of the PCT—the commissioning body here—as regards what we can or cannot put out.

Q41 Chair: But hang on a minute, Mr Lyons. The PwC report actually says, in the sentence before the passage that Richard quoted: “We are unable to comment on the effectiveness of the conduct of the investigation”—that is your own internal investigation—“as it was not Serco’s practice to retain detailed records of its investigation”. So there are all these allegations flying around, you do an investigation, quite properly, but you then destroy the evidence and you are “unable to share...information with us”. That is not transparent, when you are trying to learn, in this instance, from what went wrong to try and put it right next time.

Alastair Lyons: Madam Chairman, we have gone back to PwC and said that we have that information. It is retained and in the reply that we have made, we have denied the statement that PwC made. I have questioned my team personally, having read that, because I could not understand it and it was completely against everything that I believe our business does. They turned round to me and said, “We refute the statement that PwC made.” We have taken it up with PwC, but it has maintained the statement in the report.

Q42 Mr Bacon: So Mr and Mrs Taxpayer paid a lot of money through the NHS for PwC to commission

the report, but at the end of it we are still arguing about the facts. You can see from our point of view, as scrutineers of value for the taxpayer, that that is wholly unsatisfactory. I understand that there is another issue, because the report is addressed to NHS Cornwall and Isles of Scilly PCT, which ceased to exist during the course of the investigation that led to the review.

Alastair Lyons: Exactly.

Q43 Mr Bacon: So I can understand from PwC’s point of view how difficult it must have been to get sensible instructions from a client that was in the process of evaporating. I will go back to my earlier question about the extent to which the client side is responsible for many of these failures, which, having represented the consulting industry for a while 20 years ago, I know often to be true. There is still the central question: in light of all these arguments and spats and your previous record, why should taxpayers trust your company?

Alastair Lyons: First, we have been open throughout the course of these investigations, which have taken place this year. We have said to the various bodies that have mounted investigations that we will have a completely open book and will work and co-operate with them fully. Secondly, a whole series of reviews are taking place, including in the Ministry of Justice and the Cabinet Office, into the other things that we do. We do an awful lot of other things besides the particular issues that have arisen this year that sadden me, shock me and which I am deeply sorry about. They have happened, however, and I need to ensure that they do not happen again. It is those actions that we are taking that are the main reason why the taxpayer can have confidence that you can deal with Serco, confident that Serco will deliver value for money. We will be transparent in our dealings with Government, in exactly the sorts of things that I have talked about up to now.

Q44 Mr Bacon: You are making the best fist of this that you can. You seem like a sensible, straightforward, trustworthy sort of person.

Alastair Lyons: Thank you.

Mr Bacon: But the fact remains that this is a report from a reputable big four firm and you and they are disagreeing about the fact. It is in the light of that that I am asking the question about how the taxpayer can trust you. You have not even yet got to a shared understanding of the facts with PwC.

Alastair Lyons: Can I mention what we have a shared understanding about?

Q45 Mr Bacon: It is what you do not have a shared understanding of that worries me, because that is where the distrust rises from.

Alastair Lyons: It is PwC’s recommendations that we will accept in full, if the commissioning body accepts them. We have absolutely no reservations about any of those recommendations. I do not know why we cannot agree on the facts. I know that we have done an extensive e-mail review, and I know what that e-mail review showed. I know that we have the detailed records and I do not know why PwC does not think

that we do. I will gladly take the point away and have another conversation with PwC.

Q46 Chair: Let me share another instance of Serco transparency, because are still on that issue. This is not about what you did or did not charge on the tagging contract, but is another aspect of it.

We talked about the profits that you make on your contract and, looking at the PwC report, they do not look unreasonable, on the whole. Then, if you start digging into Serco's position, there is a company called Serco Geografix whose operating profits jumped between 2001 and 2011. That company's sole customer is Serco Ltd, which is the company, I think, that had the tagging contract. It seems to me from reading it that you were charging an arm and a leg for the hardware—the tags that they put around people—and putting it into Serco Geografix's accounts. You were therefore not being transparent, but hiding it from the actual costs to Serco Ltd—the company that the Government did business with. You pretended to the taxpayer that the profit you were making on the contract was not unreasonable, when in fact it was excessive. A Policy Exchange report—I think it was Policy Exchange—showed that the costs were 60% higher in the UK than they were in Florida.

We will come later to what you did and did not do for the tagging contract, but for this contract the lack of transparency led to excess profit. To the taxpayer, that feels like a rip-off.

Alastair Lyons: That contract, Madam Chairman, was let in 2005. I believe, although I cannot say for certain because I have only been chairman since 2010, that the basis of the interaction between Geografix and the main contract was known by the MOJ customer. I know that the new electronic monitoring contracts that are currently being let have split the supplier—

Q47 Chair: We are talking about the existing contract and transparency.

Alastair Lyons: If the situation was not transparent when it was let in 2005, were it to arise now with Serco being run as it is, it certainly would not happen that such a material part of the overall arrangement would not be completely transparent to the customer.

Q48 Chair: So what you are really saying is, “We ripped you off in the past, but we won't do so in the future.”

Alastair Lyons: I don't believe that we did rip the taxpayer off. I think, as I have said, that it was totally transparent.

Q49 Nick Smith: Do you think it was profiteering, as Mr Pindar said earlier?

Alastair Lyons: I don't believe it was profiteering, no.

Q50 Jackie Doyle-Price: Or do you think that there was inadequate contract negotiation by the Department at the time, and everyone has learned since then?

Alastair Lyons: I would have to hypothesise, but clearly contract management has changed materially since 2005.

Amyas Morse: I have a very quick point in support of transparency. It is about your capacity to control what is happening in the groups. The groups are growing very fast and you have extremely rambling group structures because a lot of the growth is by acquisition. You said yourself that what you are trying to do is at the centre. The real question is, have you actually got the capacity to be in control of what is happening in the multitude of subsidiaries down below? I know you have probably got controls around profitable operation. But when we are invited to place confidence in a group, the question is, have you got controls that give central management the assurance that what they are saying, which sounds fine, is actually being carried out through the group? That is a pretty important question for us to ask.

Alastair Lyons: From the perspective of Serco, the controls that one has in the organisation are dependent on the management structures, the expanse of control within those management structures, and then the reporting, which comes through the organisation against key performance indicators and performance standards. Senior levels of management, including the board, are then able to understand what is happening in each part of the organisation, so there is clear identification if problems arise. On the one hand, you have your structures of reporting and your information. But you also need to have your lines of assurance in place—quality assurance at the first line within the operations, risk management to identify and flag up potential issues, and internal audit to examine whether the line 1 and line 2 defences are working properly. It is perfectly possible for a broad, complex organisation to have strong controls. We identified in the comprehensive reviews that we have been doing this year that there is a consequence to those issues arising. There are areas where we can strengthen our controls. We have a basic framework of control, and we need to build significantly on it.

Amyas Morse: Do you really think that you have that in place at your rate of growth? Do you really think that you have a reliable control structure at the rate of growth of your group? Do you really believe that you can rely on it?

Alastair Lyons: As I said, I think there is quite a lot that we need to add to our control structure, in order to bring it up to the level of, as you say, the current development of the group. That is what we are now putting in place.

Q51 Chair: I think that is sure. Come in on that. We are still on transparency, guys. I have got you all down. Mr Almanza, come in, and then I am going to go to Austin and then Steve on transparency.

Ashley Almanza: Thank you. May I respond to the previous question? I think it must be obvious that historically we have not had all the controls that we have needed in place. There are too many examples in here, the industry, and I would certainly say our company, where we haven't controlled the situation adequately. I think one of the strengths of the approach that is increasingly being taken by—I am talking principally about central Government because our role in local government is quite small—is that it facilitates greater control at contract level. That is

20 November 2013 **G4S, Capita, Serco and Atos**

where the control needs to be, because that is where things go wrong. We are not there yet, and as a company in the past five months I and colleagues are on record saying that we need to invest and make changes. We are doing that, but in the meantime, the client, in the form of the Government—recognising that the ultimate client is the taxpayer—can also contribute to that and is doing that by being more vigilant about performance on contract.

Q52 Austin Mitchell: I think the nub of the argument here is that to replace public monopoly with an oligopoly—that is to say, a small handful of big organisations like yourself, which are big enough to dominate the bidding and then, when they are incumbent, are too big to be replaced—the requirement from a public point of view is that the taxpayer, the Government and the National Audit Office know more about what is going on.

You all held your hands up when the Chair asked if you had co-operated. You have co-operated and the National Audit Office agrees that you have co-operated. But still it has not been able to audit elements of the business deemed by you to be commercially confidential. In an effective audit, doesn't the National Audit Office need to be able to follow public money wherever it is going and to know about your pricing structures—what functions are charged to what sections of the organisation? You might be manipulating profits from one section to another. Doesn't it need to be able to do a more thorough audit than it has been able to do? That would replace the need to have particular audits, like this one from PricewaterhouseCoopers, on one particular section. Doesn't that work need to be done by the National Audit Office for all of you?

Ashley Almanza: If I may respond, I think the National Audit Office is uniquely placed to audit commercially sensitive information, because I think that private providers would have complete trust in the National Audit Office to protect commercially sensitive information, while still auditing as much as they want. I think, and I stand to be corrected here, that there is no problem in providing commercially sensitive information to the National Audit Office, if that is what is required.

Q53 Austin Mitchell: You have not provided them in this instance.

Chair: No, to be absolutely fair, we think that this is great progress. Certainly, Richard and I chatting here think this is great progress. You haven't provided it because of the terms of your contracts with the Departments. What we need is for Government to accept—I have raised this issue with the Prime Minister on, I think, three separate occasions—that as part of the monitoring of the contracts where private providers are providing public services there ought to be open access to those contracts by the NAO. If you guys are happy with that, we have two sides of the argument together. We may then be able to persuade the Government that this is a good idea and in the taxpayers' interest. I hope that that is where we end up.

Ashley Almanza: Briefly, Mr Morse could clarify here, but I believe, Mr Mitchell, that we have provided all the information that has been requested over and above what was contractually required.

Q54 Chair: You have been very co-operative with them on this, but any contract that you have with any bit of Government—the National Audit Office, and therefore reporting to us, does not have access. I am right in that, Amyas?

Amyas Morse: Yes. Also, just to put on the record, for this Report, G4S gave us absolutely full access. They were the ones who gave us that. I am not complaining, just stating, because this was voluntary co-operation, but we did not have the same level of access from all the companies. Some said that there were bits of information that they did not feel they could share.

Keith Davis: That's right. We did not have quite that same level of access. We got a great level of access; in some cases it was a little bit more summarised.

Q55 Chair: From the four sitting in front of us today?

Keith Davis: In some cases we did not get full access to non-open book contracts, for example, and there were reasons for that.

Austin Mitchell: We can't follow public money wherever it goes because there are areas that are deemed to be commercially confidential.

Chair: Not for the NAO.

Austin Mitchell: The NAO.

Q56 Stephen Barclay: Mr Almanza, do you always see the Department's business case? On the contracts to which you provide services, would you always see the Department's business case?

Ashley Almanza: I don't believe we would. I am not 100% certain of that. By that I mean, when central Government let contracts to private sector providers one of the constant reference points they have for the alternative is public sector provision. I don't think in all cases we are able to see the business case from the Government's point of view.

Q57 Stephen Barclay: There may be small elements that would be redacted. But in terms of understanding the needs of the client, would it not help you and supplier innovation to understand the rationale behind it?

Ashley Almanza: Yes, it would.

Q58 Stephen Barclay: It would. Would it be welcome if you were to be given access to the business case?

Ashley Almanza: Again, just to clarify. There is a great deal of information exchange for us to understand the customer's needs, but the economics is what I was referring to.

Q59 Stephen Barclay: Sure. Does the Department see your business improvement plans?

Ashley Almanza: Do you mean for the company as a whole or for individual contracts?

Q60 Stephen Barclay: I am just going on when you are telling shareholders about business improvement plans to strengthen margins in 2014–15, is that the sort of information that the Department would see?

Ashley Almanza: Well, that comment was obviously in relation to a global business, most of which is not Government business. In the case of individual contracts with UK Government, in many of the newer contracts we are required to share with the customer—that is, the Government—improvements in our business performance, and in some of those contracts there are gain share clauses. I think that was a point that Paul was making earlier. There is an incentive then to find savings, knowing that the client and the service provider share those on a 50–50 basis for example.

Q61 Stephen Barclay: But savings may be achieved simply through displacing cost. To what extent would penalties in a contract reflect the true cost to a Department?

Ashley Almanza: I am afraid I don't follow the question.

Q62 Stephen Barclay: A contract might say that you have got to get prisoners to court, and if you don't do so you are fined. To what extent does the fine reflect the cost of the loss of court time, the cost of the lawyers, the true cost to the Department?

Ashley Almanza: I do not know the answer to that, but I know that the penalties on some of the contracts make the contracts loss-making, so they are not trivial.

Q63 Stephen Barclay: This example is from Scotland so it may be slightly different due to devolution. G4S was fined in 2012 £335,000 for nearly 22,000 occasions, which seems about £15 a go. I don't know what the cost is of losing court for a day. I think an Old Bailey study 10 years ago suggested it was £110 a minute. It is clearly going to be significant. This is what I am trying to understand. You can have a contract that says you have got to do X—the activity—but if the penalty does not reflect the true cost to the Department because the penalty clause is very limited then you are skewing the basis on which the service is being tendered. I am trying to establish whether the penalty clause—where you do not do what you say you are going to do—reflects the true cost.

Ashley Almanza: I do not know the answer to that. Again, I would say that the penalties in the contract are prescribed by the customer and they are typically not trivial.

Q64 Stephen Barclay: Well, perhaps Capita could help. Another cause of court adjournment and court time being wasted is translators not being available or speaking the required language. The *Evening Standard* reported what it called a “risible” fine of £2,200 for a series of failures on the ALS contract. Can you help us as to what penalties reflect true cost?

Paul Pindar: I am certainly happy to help. The first thing to say is to take the instance of what would have happened if a service had not been outsourced—because the ALS service had not been outsourced.

Financial information did not exist on what the performance actually was and there were certainly very many instances of translators not appearing in court. So it is important to recognise that the sheer process of outsourcing itself provides information and accountability.

Q65 Stephen Barclay: Sure, so when you are negotiating those prices, you are negotiating them in a vacuum of data. Is that what you are saying?

Paul Pindar: Sometimes you do not have the required quality of data that you would like.

Q66 Stephen Barclay: So it is difficult for the Department then to price it accurately?

Paul Pindar: It is difficult for everybody to price it accurately. The second thing I would say is that, if you take Ashley's comments before, there needs to be a balance. If we are trying to create an effective market where public and private sector work together for the benefit of the taxpayer, then if you levy such heavy sanctions on the private sector contractor that it drives him into a position where the contract simply has no viability, then you actually end up killing the market. In the instance that Ashley gave you, his response was that he could not tell you exactly what the penalties were, but it drove the contract into losses. As soon as you get to a point where the service credit regime drives the contract into losses, it is fair to say that there is a pretty heavy sanction for that supplier already.

Q67 Chair: You didn't lose any money on that contract.

Paul Pindar: On ALS? That was the third point that I was coming to.

Q68 Stephen Barclay: That was not a heavy sanction.

Paul Pindar: No, let me finish please. We lost a huge amount of money on the ALS contract, but again the important point is—

Q69 Chair: You were not fined.

Paul Pindar: No, but there is a significant difference here. You should not naturally assume that the way of motivating a private sector partner is simply to hit them with the threat of service credits or fines. The far bigger driver to the vast majority of private sector providers, of which we are one, is the reputational desire to do a good job. To come back to Margaret Hodge's point, on the ALS contract—which we did not sign, but inherited as part of an acquisition—we realised pretty quickly that it was in difficulty. We went back to the MOJ and Capita literally threw money at that service to make sure that we could get a high level of performance as quickly as we could. So we were not fined. The service credit regime that was written into the contract was nothing like as onerous as the losses that we suffered. During that period we suffered losses of £6 million to £8 million. If you talk to the guys in the MOJ, the comment that they would make is that they had a huge amount of respect for the fact that, first, we did not walk away because we did not sign the contract, secondly, we

20 November 2013 G4S, Capita, Serco and Atos

stepped up and did the right thing and invested heavily. If you look back over the performance of that contract over the last 12 months, you can see that there has been systematic improvement. That performance is now at its highest level in the history of the contract; and the cost to the taxpayer of the translators provided to courts is far lower than it was before the service was outsourced. I say that in the spirit of balance. Do not assume that service credits are actually what drive the right behaviour. They do not always.

Chair: I have a lot of people waiting, Steve. We were on transparency and I allowed you to deviate from it quite a lot. May I come back to you, otherwise it would be unfair?

Ian Swales: You might want to stop me here, because I wanted to go back to the issue of—

Chair: I brought you in because you asked earlier.

Q70 Ian Swales: I am sorry. I had to leave the room: a local crisis. We spoke about competition and I suppose transparency relates to this. One of you said at the start that Government procurement is getting more sophisticated and formal. How do you react to the charge that this is in your interests, because it keeps a lot of other people out and the overhead for getting involved in Government contracts is a huge disincentive?

Ursula Morgenstern: We on our side also do not necessarily welcome protracted procurements. There are often multi-million pounds of costs and we need to be careful about what we can bid for. Especially in the last four years since the financial crisis, we have seen competition increasing significantly, to the extent that we are all selecting very carefully what we go for. Just to give you an example, at a recent business process outsourcing from a Government Department, there were 30 technology companies and 60 other companies trying to assess whether to go for that bid. So at the moment the competition definitely does not feel restricted, but very ferocious.

Q71 Ian Swales: Actually it was you who said the bidding costs are quite high. You said that earlier and I think you have just said it again. So if you are going for a contract, let's say £50 million, how much does your company think they have to spend on the bidding process? I know each contract will be different, but just an order of magnitude.

Ursula Morgenstern: We normally would look at 1% to 2% of the contract value.

Q72 Chair: And the rest of you? I think that is an interesting figure, Ian, to get from everybody. What percentage do you spend on bidding?

Alastair Lyons: As a non-executive chairman, I wouldn't have that number. My chief executive colleagues would have that.

Paul Pindar: I completely agree with that.

Q73 Chair: Can you write to us with a number, Mr Lyons?

Alastair Lyons: Yes, I will certainly.

Q74 Chair: And the other two? Let's just take the other two.

Paul Pindar: I think Ursula's estimate is pretty spot on, 1% to 2% of bid value and I think your point is right.

Q75 Ian Swales: It is an important factor, because ultimately the taxpayer is paying those costs because you are bound to put them into the value of the contract.

Can I just ask one other question and then I will pass back to the Chair. Have any of you knowingly bid for a contract at a loss—in other words a loss leader?

Ursula Morgenstern: No.

Q76 Ian Swales: For wider reasons, that you might have a calculation that longer term you are going to make money some other way?

Alastair Lyons: Not to my knowledge.

Chair: I must stop Mr Lyons because I think with a number of the health contracts—we are coming back to another of yours—you come in at a very low price and then find you can't run it at that cost. I think that is one of the generic issues that comes out of this—that you undercut, come in, then you find it is too difficult to deliver within cost.

Q77 Ian Swales: I was going to come back to that. So, the other two, have you ever knowingly gone in at a loss?

Ashley Almanza: I don't believe so.

Q78 Ian Swales: Going back to the point that the Chair just made, one of the figures mentions the initial value of the contracts and the amount that ends up getting paid. What proportion of the contracts that you take on from Government end up being renegotiated or resulting in a higher value than you originally won the contract for? Can you give us a rough proportion?

Paul Pindar: I haven't answered your first question yet. Your key word was "knowingly". The odd mistake, but we never ever knowingly bid for contracts at a loss, because a house rule is that every contract has to be self-sustaining. The vast majority of our contracts have not had significant change in them since we negotiated them, although you will sometimes find that the revenue value of a contract will increase and it will increase for three reasons. First is inflation, when you see the fact that a contract value is 10 years higher than the contract that you signed earlier—the contracts are RPI-indexed so you should expect to see them go up. Secondly because there has been a change in volume. Some contracts are volume related and therefore if there is higher activity, they will go up. Thirdly, there may be change of scope. One of the things about running a contract is that you learn a lot during the process and therefore in the course of a conversation with a client you can often go back and say there is a better way of doing this.

Q79 Ian Swales: And the others?

Ashley Almanza: Yes, I would give a similar answer to Paul. In the vast majority, no; there have been renegotiations where we have been called in by central

Government and asked to reduce our prices. The other thing is the volume point. It comes down to what the customer wants up front. Sometimes the customer wants us to take volume risk and on other occasions they don't. When we take that volume risk, then typically the value of the contract can be higher than you expect at the start. It can also be lower.

Q80 Ian Swales: I think one concern I would certainly have and we have had examples of it, is what you might call the aircraft carrier syndrome. If you have already built half the aircraft carrier, it is quite difficult to say, "No, actually we are not accepting this contract escalation," because it is a complete gun to the head situation. On defence procurement, of course, people win the contract and then we typically end up paying double and beyond the original contract. Are you saying that, with the contracts that you take out, the public sector retains the right level of flexibility to get out of the contract again?

Ursula Morgenstern: I think you can get out of a contract if you want to. We see that in the private sector. Do we see that to a vast extent in the public sector? Probably not. But how do you design your contract from the very beginning? The volume question was raised. One of our contracts went up. We are paid by transaction so if the transactions go up—in that sense, it is just a feature of the contractual mechanism where we are taking on risk because the volumes can go down as well. So there is the question: how do you, as an awarding Department, want to design your risk-reward system back to the contractor?

Q81 Ian Swales: My final question. One of the things that we hear around the Committee table is "We get into difficulties". To be fair, it is usually IT projects, and I do not think any of you major on IT projects, but we find the public sector having to pay a lot of money to get rid of an underperforming contractor. How many times have you been awarded a contract, got part-way through it and then the public sector has effectively fired you? How many times has that happened within the period of the contract?

Chair: Anybody had a contract actually stopped?

Alastair Lyons: No, I am not aware of that.

Ursula Morgenstern: There will be individual project issues where, again, it is a question of how do we go and fix them. Coming back to your point, and as Mr Pindar pointed out, fixing it is often where the penalty, or the costs, really lie. That is where there is a comparison to service penalties. I would say that it is individual projects but not big contracts.

Q82 Ian Swales: With G4S, we have the Olympic security issue. I think that even then you technically did not lose the contract. You had to effectively pay for a whole different way of doing it, but it was still your contract. Am I right?

Ashley Almanza: There were two parts to the contract: the Olympics and the Paralympics. We delivered 80% of the security on the Olympics and paid £88 million to the taxpayer. On the Paralympics, we fulfilled the contract.

Q83 Ian Swales: And have you ever lost a contract in your organisation part-way through?

Paul Pindar: No.

Q84 Mr Bacon: Individual learning accounts—that was terminating in December 2001.

Paul Pindar: If it was, I cannot recall it, to be frank with you.

Mr Bacon: The police were called in so the whole thing really hit the buffers quite fast and I think I am right in saying that the contract was terminated.

Q85 Chair: I am going to pick up one thing that Ian said and it is an Atos point. On page 23, figure 6 and page 24, figure 8, you make a lot of money on just increasing the contract value; 46% of the revenue comes from just increasing the contract value. This is not very good competition. Over the page, two thirds comes from the contract value having increased.

Ursula Morgenstern: There is one main contract which is sitting behind that number. That is National Savings and Investments, which when it was originally outsourced to Siemens—

Q86 Chair: Why do we have to add so much to the contract value without competition?

Ursula Morgenstern: Because it is payment by transaction, so funds-managed. For NS&I, I think it was initially, in 1998, £60 billion funds-managed and now it is over £102 billion-funds managed and that is good news.

Q87 Chair: Do we get any economies of scale when we add more contracts in? Or is it the lower rate that you agreed?

Ursula Morgenstern: Actually, I must admit that I do not know the contract details to that extent. When the supply chain conversations started with the Cabinet Office, one of the requests was actually that NS&I would take on further work because it is relatively low cost per transaction and therefore, in that sense, helps to reduce taxpayers' money.

Q88 Ian Swales: Can we use that as an example of something else which I think is mentioned in the Report, which is essentially the way you get locked in. How long is the NS&I contract for?

Ursula Morgenstern: It was recomputed just this summer, after what I would say was a fairly tough competition. Yes, we retained that contract, but again we have a very good reputation of delivery and we are providing a further £400 million of tax savings over the next period.

Q89 Nick Smith: Do you have a view on what for Government would be a good length of time for a contract? Governments change, IT changes, and new competitors come in and out. What is the right time for a contract in the round, or is that too simplistic?

Paul Pindar: It is a bit simplistic because it depends entirely on what you are being asked to do. When you are trying to create a very significant step change reduction in cost, usually the way you do that is by investing a lot of money up front, so it is quite possible to be investing tens of millions of pounds

20 November 2013 G45, Capita, Serco and Atos

with a view to dropping a cost base. In those situations it is very unlikely that the contract would be viable, certainly if it was less than five years; seven years would probably be a better term typically. If you have a more vanilla contract or a simpler contract to deliver, which does not require a huge up-front investment, then three to five years would be normal. Unfortunately, at the risk of laying into the IT guys again, our industry has been tainted with some of the practices of the big IT players. People have got involved in very large projects which have had a long period of time and then the clients have been locked in. With the kind of things we do as a team, that is probably less of a risk.

Q90 Fiona Mactaggart: I want to come in on contracts and when they end and so on. I draw your attention to figure 6 in the NAO Report—this is a question for you, Ms Morgenstern. It points out that most of the contracts—around two thirds to three quarters—that the companies in front of us acquire go through a full competitive process. It is different for Atos, which seems to have contract extension in 46% of cases.

Ursula Morgenstern: It is two contracts—the value of those two contracts. One is the NS&I contract, which I just mentioned, and this figure comes from before the recompetition, which happened this summer; the other one was the Ministry of Justice. These two contracts alone explain that number. Two thirds of our business at the moment is in the technology space.

Q91 Fiona Mactaggart: I wanted to ask about a specific contract that has been in the news today in the *Daily Mirror*. It is talking about the contract you have for advising the DWP about DLA and personal independence payments. I have seen a memorandum circulating in the DWP saying that the Atos service will, for the time being, be on a revised basis. Is that because the contract is over?

Ursula Morgenstern: I am glad that you brought that up. I have not seen the memo myself. The contract came to a natural end at the end of March. Atos would never withdraw from front-line services so we continue to provide that service to the Department on a short-term basis, while the Department is reconsidering its requirements, and we will continue to do so until the new benefit comes in, because the personal independence payment will replace the DLA benefit and we will then continue to work with the Department on that matter.

Q92 Fiona Mactaggart: I understand that. We know that the DWP has not let a substitute contract to anyone else, but what are you actually doing? It seems to me that this is a big issue, in this area of the private sector doing public sector contracts. I am not saying it is your fault; it seems to me that it is probably the fault of Government, but if there is no clear process when a contract ends and they are just hoping that you are going to carry on doing things through good will, which is what it sounds like, what happens when you choose not to continue to do stuff?

Ursula Morgenstern: Again, the Department asked for short-term extensions and we will continue to

supply those short-term extensions to the Department as long as it is required.

Q93 Fiona Mactaggart: Is that month by month? What isn't being done?

Ursula Morgenstern: It is a contract that we have had for a very long time. We have been in the benefits arena since 1998 and we will continue to do the face-to-face benefit assessments for DLA that we have done for years. So this is a contract at its end of term.

Q94 Fiona Mactaggart: But part of the contract was advising decision makers when there is an appeal. The memorandum that I have seen says that in children's cases that will continue, in something called SR cases that will continue, but in all others the people in the Department are advised to find out information from voluntary organisations, Google, and so on. That seems very strange.

Ursula Morgenstern: I really cannot comment on the memorandum; I have not seen it.

Q95 Fiona Mactaggart: But you can tell us what you are not doing.

Ursula Morgenstern: We are continuing to do the face-to-face assessments.

Q96 Fiona Mactaggart: For everything? Are you continuing to do everything that you used to do?

Ursula Morgenstern: At the moment, I don't want to say. I cannot answer it in that complete statement, but I am certain that we will continue to do the face-to-face assessment. I am happy to come back to you with a specific answer to your question.

Q97 Fiona Mactaggart: That would be helpful. In a way, we have been trying to get into an issue of transparency. I am not saying that you are not being transparent, but where a service has traditionally been provided by a private sector provider, and then the contract concludes and nothing seems to be provided in the gap, the challenge for me is: what is our role to ensure that our constituents continue to get the services they require?

Ursula Morgenstern: I am happy to provide you with the details of what may have changed. Again, at the moment, my understanding is that we are continuing to deliver the service we have delivered in the past. I will make sure that I get that additional information to you.

Q98 Meg Hillier: Can I just pursue this briefly before I go on to a couple of quick-fire questions? How are you being paid for this extension of contract?

Ursula Morgenstern: Again, it is a continuation of the terms we had.

Q99 Meg Hillier: So you are not being paid any more because the contract has ended?

Ursula Morgenstern: No.

Q100 Meg Hillier: Will there be a period of notice that the Government has to give you?

Ursula Morgenstern: It normally has to give us a period of notice.

Q101 Meg Hillier: Do you know what that period of notice is?

Ursula Morgenstern: For this contract, I cannot tell you.

Q102 Meg Hillier: Could you write and tell us that as well?

Ursula Morgenstern: Again, I can get that to you.

Q103 Meg Hillier: On transparency, I have some quick questions for each of you. How common is it for a client to ask you to identify the pay rate for the staff you are employing, and is that changing? If I could get a quick answer from each of you, that would be great.

Ursula Morgenstern: Could you define that?

Q104 Meg Hillier: The hourly pay. In London there is a living wage campaign, and obviously you have to pay the national minimum wage at least. There is a lot of discussion. A number of councils, for example, as one of the clients, talk with the Government about setting a minimum wage rate. Obviously, if some of you are paying just the minimum wage and some of you want to pay more, you potentially have an unlevel playing field.

Ursula Morgenstern: I must say that I have never been asked by a Government Department whether we are a living wage employer. We are just adjusting our London living wage.

Q105 Meg Hillier: So you have never been asked?

Ursula Morgenstern: Again, I need to be cautious when I make that statement.

Chair: Meg, is this really relevant?

Meg Hillier: It is about transparency. I have one question about record-keeping as well.

Chair: Go on, but I don't see how it is relevant.

Q106 Meg Hillier: Well, perhaps everyone else can just answer.

Alastair Lyons: Again, my understanding is that we are not generally asked that question within the competitive process.

Ashley Almanza: It is mixed. Sometimes we are asked.

Paul Pindar: We are not generally asked.

Q107 Meg Hillier: Okay. That is helpful. On the transparency issue more generally, how long do you keep records for in your organisations and is it ever a contractual requirement that you must keep records for a certain period of time?

Ursula Morgenstern: Again, I would not have the details on the specific contracts, but of course we would keep records at least for the contract length. If they are financial or legal documents, there will be longer obligations.

Alastair Lyons: Again, typically that would be specified in each individual contract.

Q108 Meg Hillier: So it is the client that decides, not you.

Alastair Lyons: As I understand it.

Q109 Meg Hillier: Okay. Mr Almanza?

Ashley Almanza: There will be a statutory requirement that we would comply with, but if the contract required us to hold them for a longer period, we would do that.

Paul Pindar: Same answer.

Meg Hillier: Thank you.

Q110 Nick Smith: I want to pick up on some PR that G4S put out yesterday, Mr Almanza. It comes back to this business of contracts. I want to know how any right-minded person could think it appropriate for G4S to consider itself to be contractually entitled to bill for monitoring services when equipment had not been fitted or after it had been removed. How did that happen?

Ashley Almanza: I need to deal separately with the reasons why the company at that stage thought it was contractually entitled to bill in both those circumstances.

On the first case of billing before the equipment was fitted, I will make a couple of comments. Earlier generation contracts allowed you to bill on receipt of the order, rather than on fitting the equipment. That had changed by the time this contract came along. There was some dialogue between the company and the customer, and the company said that billing would start on the day after an attempted induction. Induction, as you will understand, is when you visit the subject on the first occasion to say, "This is what is going to happen, this is how it is going to work," and so on. The company believed that the customer had accepted that—that was back in 2009—and continued to bill on that basis. When this surfaced in April or May, we started to look into it. We brought in independent—

Q111 Nick Smith: May I interrupt you? You said it was discovered in 2009. Did the Government contractor, the Ministry of Justice, raise it with you, or did you realise what had happened internally?

Ashley Almanza: No, I believe what happened was that the MOJ asked a series of questions—"When are you billing and when are you stopping?" I believe the answer was along the lines of, "We bill the day after an attempted induction, and we cease billing on receipt of a revocation order." An order should be received from an appropriate authority, such as a prison governor or the police, or it could be a court order. We keep the case active and keep billing until we get a revocation order. That was the practice then, and the company believed it was correct.

In June I brought in Linklaters to perform an independent review. I had a meeting with Linklaters on Monday evening, and we made an announcement yesterday. We have accepted Linklaters' findings, although its review is still ongoing. Its view is that there was dialogue with the customer, the company and the managers. It sincerely believed that it was in accordance with the contract and it had been agreed with the customer. However, as we announced, I think it is unacceptable to bill before equipment is fitted and to keep billing after it has been removed.

20 November 2013 G4S, Capita, Serco and Atos

Q112 Nick Smith: You have given us quite a technical answer, and you say now that you realise the difference between right and wrong, but I can't really understand why you didn't work out what was right and what was wrong in 2009.

Ashley Almanza: If you are asking me personally—

Q113 Nick Smith: The company.

Ashley Almanza: As I say, I think it was a judgment that was flawed. It was just a flawed judgment. I don't think we did correctly tell the difference between right and wrong. We got it wrong.

Q114 Chair: Do you agree with that, Mr Lyons?

Alastair Lyons: Completely. As far as we and our board are concerned, managers in our UK division may have genuinely interpreted the contract that way, but that is not the point. It was never right to bill when we were not doing work in respect of that billing. It was ethically wrong. It is one of the signs that we need to have an attitudinal change within our business. The business and its 122,000 people around the world should never feel that because they have commercial objectives to achieve they should compromise on what is right or on dealing fairly and transparently with the customer.

Q115 Chair: I can't work it out. If you hadn't been caught on some of the people who were either out of jail, dead or whatever, you would have carried on charging until the year 3000, according to the way you system is run, Mr Lyons.

Alastair Lyons: Again, I repeat that it was totally wrong. As far as we are concerned that might have been a contractual interpretation or what the lawyers might argue, but that still does not make it right.

Q116 Chair: Okay. Mr Almanza, given that you overcharged the taxpayer literally millions and millions and millions of pounds, what does that say about your systems of governance and control?

Ashley Almanza: The first thing I would say is that I apologised to the Secretary of State and I should apologise to this Committee and the taxpayer on behalf of our company. We did not have the systems in place that we needed to have. This was one of the examples I referred to in response to Mr Morse's question earlier. Too much was left to a small number of individuals and we did not have appropriate checks and balances in place. That is changing now as we speak.

Q117 Chair: Why on earth could this not have been detected? That's for both of you, really. I find it astounding that it was detected only when the retendering process started. Somebody must have realised. Have you sacked a whole load of people on the back of this?

Alastair Lyons: Exactly as you say, Madam Chairman, internal transparency is as important as external transparency. The understanding within management layers of what is actually happening and getting that moved through. We have a lot of work that we are currently doing in order to improve that transparency, so as to get that reporting up. It is also

a case of having in place the controls, checks, risk management and internal audit. If somebody does do something wrong, which is always possible in that work force, it is detected early, action is taken and lessons are learned.

Q118 Justin Tomlinson: Hang on. The Chair just talked about transparency, so has somebody been sacked for what has happened?

Alastair Lyons: There have been disciplinary investigations into the electronic monitoring contract. As you are aware, that is also subject to a Serious Fraud Office investigation. The SFO has asked us not potentially to compromise its investigation by our own at the moment.

Q119 Stephen Barclay: If this was the culture, how many other instances have you now found from your more recent investigations?

Alastair Lyons: As you know, there are reviews going on by the Ministry of Justice and the Cabinet Office and there have not been any instances of material issues on other contracts that have been raised to my knowledge out of those.

Q120 Chair: Have you found overcharging on other contracts?

Alastair Lyons: No, we haven't, Madam Chairman.

Q121 Chair: Have you?

Ashley Almanza: No.

Q122 Chair: Have you found undercharging anywhere?

Ashley Almanza: Not to my knowledge.

Q123 Ian Swales: Did any of the individuals concerned have a personal financial incentive under your rewards system?

Ashley Almanza: One of the things we asked Linklaters to do was to focus on why these decisions were made. Is there any evidence of wrongdoing? Or is it a case of poor judgment—sincerely held but flawed judgment? We have pushed Linklaters quite hard on that. Linklaters came to a board meeting and they will report directly to the board on the matter. We challenged quite hard their analysis and thinking. They have been really steadfast on this. It was a sincerely held but flawed judgment.

Q124 Ian Swales: To answer the question I asked: did the people concerned, the decision makers, have a personal financial reward as a result of declaring this extra business, in effect? It is yes or no.

Ashley Almanza: The answer is not directly, but indirectly of course they would have benefited from reporting higher profits in their business unit.

Q125 Ian Swales: And that would affect their bonuses—to get that absolutely clear.

Ashley Almanza: It would have.

Q126 Ian Swales: Is that true for your company, too?

Alastair Lyons: Yes.

Q127 Chair: May I ask a quick question, after which Nick wants to come back? Are you both prepared to pay the money that the MOJ has had to dole out on the PwC report?

Alastair Lyons: From the beginning, Madam Chairman, we have said that we will repay what we owe and we will repay the costs which arise to the taxpayer as a consequence of this happening.

Amyas Morse: As a question of balance, looking at your business model, which is based on retaining business, growing business in the long term as a way of generating shareholder value, these incidents are enormously destructive of shareholder value, aren't they? Is that true?

Alastair Lyons: Absolutely.

Amyas Morse: Can you give me an idea of how much value it has taken off your stock?

Alastair Lyons: Certainly. Since this first arose in July of this year, our company has lost over a third of its total value. That is around £1.3 billion.

Amyas Morse: So really it is very much in your interests to have these controls in place and not have these incidents occurring.

Alastair Lyons: It is totally in our interests—absolutely, completely.

Ashley Almanza: It is hard to attribute but there has undoubtedly been a loss of value in the company.

Chair: We are glad MOJ can send you the bill for the PwC report.

Q128 Nick Smith: Clearly, there has been massive reputational damage here. Mr Lyons, earlier you denied profiteering. Was there profiteering in this example?

Alastair Lyons: No, there was not. It was the genuine view of our management that that was the way in which it was intended to be billed under this contract. As I said, and I'll say it again, it was a wrong judgment. It was an inappropriate decision to make against the ethical code that we have as a company.

Q129 Chair: But do you accept that it wasn't what the customer intended? It might have been your management view, but the customer, that is the MOJ, never intended for you to be paid; the people who were, you know, dead or were not—

Alastair Lyons: Absolutely.

Q130 Chair: That is pretty extraordinary.

Q131 Meg Hillier: Both of you have long-standing contracts. This contract was a long-standing contract with the same client, even though he had changed department. How did things get to this point? You said in the NAO Report that you shared information with the client. How did it get to such a breakdown? You talked about partnering earlier. What went wrong?

Alastair Lyons: I am not sure that there was a breakdown as you say. As the NAO itself stated in its Report, we have said to the NAO that we were open about this, throughout the period of contract, to the Ministry in terms of the way in which we were billing. That still doesn't make it correct. The issue grew over the period of the contract as a consequence of the change to the number of open bail orders which were

granted, and also, as I understand it, the split of responsibility within the justice system between the courts, who had the authority to close the orders, and the Ministry of Justice, which was actually doing the tagging. The number of open bail orders increased significantly over that period of 2009 and 2010, so it grew as an issue.

I don't think that growth was visible to the customer. Again, we take responsibility there. We should have made it visible to the customer. It is back to what I said about transparency. We should have gone to the customer and said that there is an increasing divergence between the numbers for whom we have orders, which is what we bill on—as you know because we talk about it—and the number of people we are actively monitoring. We did not do that, and it is for that failure that we have disciplined people in our organisation; not for being dishonest, but for making the wrong judgment about what they should talk to their customer about.

Q132 Meg Hillier: I didn't want Mr Almanza to come in on that. Isn't it dishonest if you get a charge for installing equipment, for monitoring equipment and for removal if, when you remove it, you get a payment for that, and you are still charging for monitoring? That cannot be honest under any contractual grounds.

Ashley Almanza: Clearly it was wrong and unacceptable. You asked what went wrong. I think nobody stood back from the detail. There was a dialogue going on at a technical level saying, "We start billing the day after an attempted induction visit." Remember, historically it would be on receipt of orders, so even earlier. So I think there was an element of organisational conditioning around this. Nobody stood back and said, "Over time, what does this mean for the client? What is the overall impact?" In my view, that is where it went wrong.

If one focused on the technical detail of the contract, I think it was perfectly possible for a reasonable person who had been working there for a long time to call it either way and we called it the wrong way.

Q133 Meg Hillier: It was the oversight of a team that had got used to working in a certain way.

Ashley Almanza: Precisely.

Q134 Meg Hillier: So a governance issue?

Ashley Almanza: Precisely.

Q135 Mr Jackson: I thought you'd forgotten about me. I think this is the first question that is not about transparency. If we look at page 25 of the Report, I would like to ask a few questions about small businesses. Obviously, one of the strong arguments from the Government played in aid of engagement of private sector contractors for public services is the macro-economic effect of Government money trickling down into small and medium-sized enterprises and the social value and the advantages of cumulatively managing quite long supply chains that involve SMEs. Yet there is quite a disparity among the four of you in the revenue that you are able to disburse to SMEs, given that the Government's

20 November 2013 G4S, Capita, Serco and Atos

aspiration is 25% of the contracts. The worst is Serco, at 3%, and the best is Capita, at 33%. What concrete proposals are you putting forward to observe that mandate, that social contract, from Government to pass on work to small businesses? Are Serco and Atos concerned that you are very low on those figures in the Report?

Alastair Lyons: Perhaps I will kick off, as I am bottom of the class on this one. It very much depends on the nature of the contract.

Mr Jackson: I thought you would say that.

Alastair Lyons: That is not in any way seeking to duck the question. If you take something like the Work programme, 70% of all the contract value for that went into small businesses, because the way we delivered the Work programme was through non-governmental organisations and small businesses, working on the ground with people. It was us acting as an integrator, rather than as a provider.

Q136 Mr Bacon: And the risk transferor, so that the little local charity or SME would get the risk as well and you in the middle would take a cut?

Alastair Lyons: No, absolutely not. As the integrator we take responsibility for that delivery, so if an SME lets us down, it is us with our neck on the block, not them.

Q137 Mr Bacon: There was a question mark there, because that was what A4e were doing. They were definitely transferring risk, but you are categorically saying that you weren't?

Alastair Lyons: No.

Chair: Even in the Work programme?

Alastair Lyons: I do not believe that we were transferring risk in the Work programme. I will gladly check my facts, Madam Chairman.

Q138 Mr Jackson: In fairness, it is a more complex picture. Obviously, as we learned earlier, you take the reputational damage, even if you subcontracted to SMEs. Please continue, Mr Lyons.

Alastair Lyons: I was going to draw the parallel between that and, say, the Atomic Weapons Establishment, where clearly it is impossible for us to subcontract to SMEs. Or take Northern Rail, where you are a provider of a mainstream service and therefore have to have all that tightly within your own controls and governance structure. If you take that number of 3%, the latest quarter's number for us is 7%. That excludes our joint ventures with AWE and Northern Rail and if you add that in, it is 12%. Add charities on top it is 17%, so it is nowhere near as low a number as that.

In terms of the drift of your question, because we are an integrator and believe in seeking to deliver services which are directly relevant in the particular communities, it would be our first port of call to go to small organisations to do that, rather than our last.

Q139 Mr Jackson: Ms Morgenstern, you are next on the naughty step.

Ursula Morgenstern: Yes, I am. From my perspective we have 2,200 suppliers and working with an ecosystem is part of our DNA. I look at long-term

relationships. I started my life at a small software start-up and it is how I came to the UK. What I have learned from that part of my career is that a big integrator can really help me to get access to the market and to finance. It is also a relationship that needs to be nurtured. For me, success is when I can see that some of our small companies are not falling into your category any more because they have grown with us. For me, it is about long-term success.

Q140 Mr Jackson: Sorry, you are making a cogent point, but one of the criticisms of all of you is that integration can often mean that you line up these tasty businesses to gobble them up. That is one of the criticisms. You get that critical mass from the Government contract, then you can acquire those companies.

Ursula Morgenstern: Again, we have acquired only one small company here in the UK. That aside, coming back to why I think long-term partnership is so important, there are also the bidding costs to be raised. I need to make sure that I have a partner that is part of my solution. My team understands how to bid, mostly in our case with small technology companies, to turn them into a solution again and again, so they do not have to put up their costs or sit there for 12 months and dedicate a person to us. That is why I think long-term partnership is, for me, the main criterion, so I go for making sure that, when we commit, that is a long-term success story. That helps with a number of issues that have been raised before, to allow them to compete in that market.

One of the questions raised was: how can it be made easier for small companies to compete? Often, the terms and conditions and, as you raised, the service penalties cannot be borne by companies of that size; that would put their existence at risk. We have seen that in the personal independence payments contract. At the moment, the assessments take double the time assumed, so we are paying them double the money we are getting from Government, because that is the only way they can gain the experience and get up to speed. There are some real benefits we can give the smaller companies, but how would you make it easier for them to work directly with Government? You have to look at the terms and conditions.

Q141 Mr Jackson: So is that balance between social value and shareholder value a function of your corporate social responsibility? From the lessons of the supermarkets, they do not give a monkey's about the small suppliers; they squeeze them as hard as they can. I wonder what pressure there is for all of you to do that to your smaller suppliers.

Ursula Morgenstern: First of all, we pay them on time, if that was the question.

Mr Jackson: Good.

Ursula Morgenstern: For me, it is differentiation. The reason why I like working with small companies is that they bring differentiation and innovation. That is how I can differentiate: if I have a really great small software partner or technologies partner, that gives me differentiation. For me, that is why we are doing it. And, yes, having come from that environment, I would never not pay a partner of that size as I know

that they need to pay their staff and they might not have the credit line.

Q142 Mr Jackson: Can we ask the virtuous duo—they are not that virtuous; everything is relative—what their views are?

Ashley Almanza: Continuing in order. It is a complex question; we have made increasing use of SMEs. It has been a mixed experience. It comes down to risk transfer and capability versus the requirements of the contract. On some contracts we have got it wrong and we have held the risk because, to the point made earlier, the SME has not had the capacity to absorb the risk, then we had to step in when the SME was not able to deliver and we have borne the cost of that. So I think we are finding our way through this at the moment.

Q143 Chair: Let me ask you the same question. The one we looked at where the Government really wanted SMEs was the Work programme. Both of you have Work programme contracts and all the evidence we had was that the risk was entirely transferred to the local voluntary provider who had been doing welfare to work advice for ever and ever, and you had none of the risk: you just took the top 10%.

Ashley Almanza: I will answer for our company. We are the prime contractor and ultimately we bear the liability with the customer. In the case of welfare to work, actually the partnership has been quite successful, and that has been a function of the capability. We have used, and paid, not-for-profit organisations, for example, and they are highly capable. They have been able to take that risk on and manage it. But the financial risk remains with us, ultimately, and that is complex.

If I may—just a final point—when we think about the social value here, we employ 45,000 people in the UK. Our margins mean that of the £1.7 billion of revenue, in excess of 90% is spent in the UK, most of that through payroll and suppliers. When we think about SMEs and outsourcing, we are also making a choice about whether to give our people employment, or someone else employment. The calculation is complex.

Paul Pindar: Ours is a really simple answer. We have company policy where we try to achieve the Government target of 25%. We are probably luckier than my three colleagues, because the nature of the things we do makes it easier, so I am not sitting here being virtuous; it is just easier. As an example, we are heavily involved in training. Training is an industry where there are a lot of one-man, two-man and small enterprises, so we give a lot of work out into the training arena.

My colleague's comment is exactly right: you have to work on the basis that you've got financial risk, because the reality is that we do bear the financial risk. We have reputational risk, because if they do not deliver it is our neck that is on the block, and we have delivery risk. You have to balance those, and you have to know the people who you are working with. By and large, it has been a pretty successful experience for us.

Q144 Jackie Doyle-Price: We have heard some encouraging stuff today, and I thank you for engaging with the Committee so openly and frankly. But I have a very serious concern that what we are seeing is the emergence of public sector monopolies. That could still result in good outcomes for taxpayers because frankly, I believe that the Government are pretty rubbish at delivering such things, so the more we diversify, the better. But the degree to which it can be delivered effectively and with good value for the taxpayer ultimately depends on a smart customer, and certainly in the contracts that the Committee has looked at, we have seen some very poor examples of contract management. It is fair to say, as some of you have alluded to, that there is something of a journey on this and there are changes, but it becomes almost like a hydra—you get good practices in one part but not in another. Looking at the model of your business, it is very public sector driven, but you all have some private sector contracts. Is that correct?

Paul Pindar: The private sector is the biggest sector for us.

Q145 Chair: But you are mainly UK. That is the difference.

Paul Pindar: Yes.

Q146 Jackie Doyle-Price: Are there any lessons that you can share with us in terms of how much more effective private sector customers are than Government Departments at negotiating contracts with you?

Ashley Almanza: Again, most of our business is private sector—I am new to this firm, but looking at the history—and I think that the difference 10 years ago would have been much greater between private and public sector. If you look at what the Cabinet Office is doing to share best practice and to bring people in from the outside who have worked as procurement officers and procurement managers in the private sector, it is definitely having an effect. I think in some areas the Government has been quite innovative and has used its buying power in a way that many of our private customers cannot because they do not have the scale. We have some very large private customers who use their buying power, but by and large we have a very diversified private sector portfolio. Whereas Government is increasingly using its consolidated buying power to get better terms from the marketplace.

Q147 Jackie Doyle-Price: Typically, are the contract lengths that you sign with private sector customers longer, shorter or equivalent to those you sign with Government?

Ashley Almanza: Again, it very much depends on the nature of the contract. If it is a big capital investment up front, it is typically a long-term contract, which applies whether it is private sector or public sector. So it is driven more by the nature of the business than private/public.

Q148 Jackie Doyle-Price: Does anyone have anything else to add?

20 November 2013 G4S, Capita, Serco and Atos

Alastair Lyons: On the way in which the Government is procuring, I would add that the Cabinet Office now has the Crown representatives. If we were dealing with a private sector customer of the same scale, they would probably have more than one person devoted full time to managing the relationship with us, rather than, as is currently the case, a part-time responsibility in the middle of a host of other responsibilities that that individual also has. Again, it is part of the journey that the public sector is on, but that is a particular point that I would pull out.

Ursula Morgenstern: One difference I would note is that, once we are in a long contract, in the private sector it is probably easier to renegotiate because sometimes you find that circumstances have changed, either on the supply or the client side. There is probably a less rigorous structure due to the procurement rules in the private sector, so it is easier to say, "Okay, let's change because this doesn't make sense any more." Of course, with public procurement that is much more challenging.

Q149 Jackie Doyle-Price: Because the taxpayer will continue to pay, basically.

Ursula Morgenstern: That is one of the differences.

Q150 Jackie Doyle-Price: Mr Pindar, most of my questions are now directed at you, so it would be helpful if you want to share some observations. I was struck by what you said about the fact that, quite often, contracts are managed at a junior level. That is consistent with what Mr Lyons has just said, in the sense that you have a relationship manager who is totally responsible. One thing that we keep seeing over and over again when looking at such things is that the senior responsible owners of a contract change too frequently. Quite often, their tasks are delegated, which enables accounting officers to come to this Committee and hide behind the fact that work has been done by junior officials and evade accountability. You highlighted the fact that local authorities tend to be better at negotiating contracts. Do the projects that are managed by local authorities tend to be run by chief executives or senior directors? Is that more consistent with longer-term relationship management?

Paul Pindar: You have hit the nail on the head. If you balance the public and private sector—there are examples of where private sector comparisons are not outstanding as well, so the Government should not beat themselves up too much. If I look at the biggest contracts that we have signed in the private sector, almost invariably the chief executive or the finance director is pretty intrinsically involved, certainly in the latter stages. Equally, looking at our local government relationships, we will be pretty close to the chief executive and to the director of finance. If you carry that across into central Government, we tend to be dealing with a lower level of seniority.

Coming back to the point about transparency and expertise, I know that this will sound virtuous, but we would much rather be dealing with somebody who is really sharp and clever and able to make a decision, because we genuinely have no wish to try to be smart and to turn over a customer; we just want an educated

conversation to get a good contract and to get it done quickly. Too much time is spent with people at a low level who do not have the expertise or the confidence, which is an important word, actually to push on and get stuff done.

Q151 Jackie Doyle-Price: So you end up with a risk-averse negotiation that ends up focusing on process rather than actual outcomes.

Paul Pindar: And it takes a lot of time.

Coming back to the SME point, which is a good one, the best thing that you guys could do to encourage more SMEs into this marketplace is to make it easier for them to do business with central Government and to simplify and shorten the process.

Q152 Jackie Doyle-Price: That is cultural.

On commercial confidentiality, I get the impression that the machine hides behind this to cover up their mistakes. Do any of you have examples of where you have taken the reputational hit for something that has gone wrong? That is probably difficult for you to answer. Do you feel that you occasionally take more of the flak when there have actually been issues with the contracts?

Paul Pindar: It is occasionally part of the terms of the job.

Q153 Jackie Doyle-Price: Would you all share that opinion?

Ursula Morgenstern, Alastair Lyons and Ashley Almanza indicated assent.

Q154 Jackie Doyle-Price: My final point is about something that you raised, Mr Pindar. I liked your suggestion of sharing your proceeds of efficiency. What I see there is almost a virtuous circle in incentivising good performance. Defining performances on the basis of real outcomes incentivises you as providers, but the taxpayer obviously gains as well. Are there any examples of contracts that you have negotiated—obviously not necessarily with central Government—where you have had that written into the contract?

Paul Pindar: There is a whole variety of outcome-based contracts that are done on a win-win basis. To give you an illustration, we have just signed a large contract with O2, the telecoms company, and we have contractually guaranteed to take 30% out of their cost base and to improve customer service and the way that the customer looks at and relates to them, but the biggest gain share is actually to work with them in a way that gives better customer satisfaction and then they sell more to the customers. If they sell more, we share in some of the proceeds of that. It is about getting a continuity of interest in terms of how the contract is structured.

Q155 Jackie Doyle-Price: And that is going to be more effective than having the Government providing a service that is standard and not responsive?

Paul Pindar: indicated assent.

Q156 Mr Bacon: Mr Pindar, on what you just said about the seniority that Jackie was referring to a

moment ago, I have lost count of the number of times that I have heard people say that about the relationship between the chief executive and the finance director on the client side in the private sector, but not in the public. Do you have examples of dealing with the civil service, but dealing with nobody in the senior civil service? In the InterCity West Coast franchising not a single member of the project team was a member of the senior civil service, at the top five layers. How low do you end up dealing with people, so to speak, when you would prefer to have somebody sharper, brighter and more senior who could make a decision?

Paul Pindar: I would probably need a bit of notice to think about the question, but I have to say, from our perspective, we almost view that as part of our qualification as to what to bid for, because there are probably more opportunities to bid for than we are capable of responding to. One thing that we look at, as a bidder, is that if we do not believe we are going to get that senior level of engagement, we simply will not bid.

Q157 Mr Bacon: Okay. I was looking at the individual learning account report. This was probably way before your time, but we as a Committee looked at it many years ago. It was a web-based adult learning scheme that was great in theory and rubbish in practice, and lots of money was lost. One conclusion in our Report at the time was that Capita could have done more to insist that its concerns about risks of fraud and the necessary controls were taken seriously, but it had felt restricted by the lack of a place on the project board. Capita had asked for a place on the project board and this was denied, which meant that it felt it had to implement the contract exactly as it was, and execute the decisions of the Department, rather than, in the words of our Report, “working together to develop and operate the scheme.”

One of our recommendations out of this fiasco was—I should like everyone to comment on this, because I want to know what has changed, if anything—that, “All departments should ensure that private sector partners are integrated effectively into project management arrangements, and that partners can escalate concerns to senior staff, including the Accounting Officer.” In other words, the Permanent Secretary. Is that, in your experience in central Government, now universally true or not?

Paul Pindar: Better, not perfect.

Q158 Mr Bacon: On a scale of one to 100, where are we, and 100 is where we should be? Where are we?

Paul Pindar: 75.

Q159 Mr Bacon: Mr Almanza?

Ashley Almanza: I probably agree with that assessment. It is not universal. We typically bid on large contracts and so senior people are involved. There are regular meetings, typically monthly—not always monthly.

Q160 Mr Bacon: But can you escalate where you need to?

Ashley Almanza: Yes, I think, generally, if we need to escalate, we can.

Q161 Mr Bacon: Mr Lyons?

Alastair Lyons: This is exactly why we have asked Government to establish with us departmental forums in each Department, where our senior person sits down with their senior person, across the range of contracts we do, so as to have these issues escalated.

Q162 Mr Bacon: Miss Morgenstern?

Ursula Morgenstern: In the vast majority, we will have access to senior people, which we can escalate to. Again, that is where the Cabinet Office and the Crown Representative have become helpful, because if that does not work—if the normal escalation channel in a Department does not work—we can raise it with a Crown Representative. Having that person as a single point of contact in all situations is helpful.

Q163 Mr Bacon: The others did not answer this point, but on a scale of one to 100, where do the other people think we are, roughly?

Ursula Morgenstern: I must say that I struggled with giving exact numbers, so I would probably be between 60 and 70.

Q164 Mr Bacon: Okay. Mr Lyons, about the same?

Alastair Lyons: *indicated assent.*

Q165 Mr Bacon: Mr Lyons, I think it was you who mentioned contract management. I thought Mr Barclay was going to come in on the point about PFI contracts. I think the number is 12%—isn't it, Steve?—which get locked in a cupboard and ignored by the client side.

Stephen Barclay: We were looking at hospital PFIs, where 12% do not have anyone full time—

Mr Bacon: A significant number, and it rang a horrible bell. I think the point you were making was that, when you are dealing with the private sector the contract is much more actively managed; not only is it more senior, but it is much more actively managed on the client side. Certainly, in PFI that has not always been the case, at all.

In these more conventional non-PFI contracts—but, none the less, contracts—how much do you find that the client side is not actively managing the contract, so that there is nobody at home answering the phone, as it were? Is that an issue?

Alastair Lyons: Again, I will have to speak at one stage removed, as a chairman rather than as a chief executive, but certainly from my site visits—I do an awful lot of site visiting—and the interaction I have with our management, on the vast majority of our contracts there is direct client side management involved in that. There is a question as to whether it is managing at the right level—as to whether it is too detailed—rather than being elevated one, to actually look at what this contract is delivering overall against its requirements.

Ashley Almanza: Our experience is different, I would say. On long-term contracts we have regular contact with senior people on the client side.

20 November 2013 G45, Capita, Serco and Atos

Q166 Mr Bacon: Okay. Mr Pindar, on Army recruitment, can you tell us by what percentage the number of people attending Army interviews and selection tests to become Regular soldiers has fallen since Capita took over running it?

Paul Pindar: I do not know the precise answer to that, but it will be significant.

Q167 Mr Bacon: *The Daily Telegraph*, in early October, reported that it was a 35% fall. Does that sound about right?

Paul Pindar: It could well be, yes.

Q168 Mr Bacon: And significantly higher than that for would-be officers—nearly 50%?

My concern has been particularly prompted by a constituent who is a retired commanding officer of an Army unit. He used to run his own recruitment. He has a son who is serving in the Army now and another son who wants to serve in the Army. Ever since the first part of this year—since April or May—this other son who does not yet serve in the Army has been trying to. The litany that I had described to me of the attempts to have a form of dialogue with the recruitment system that you run would make “The Gas Man Cometh” look like a tea party. It goes on and on and on. I won’t bore you with it, except to say that they were told on one day that the event was on, then a phone call was made to tell them it was cancelled and they said, “No, we have been phoned to say it was on.” They ended up being sent to various different places around the country. Six or seven months later, this poor young man turns up to a recruitment centre, where he had literally “returned to go”, so to speak, and the recruiting corporal says to him, “Ah, hello George, you must be on phase one training by now,” to which he replies, “No, I haven’t even started yet.”

There has been a lot of press on this—it is quite obviously a shambles and it is having a serious effect on the Army, to the point where Army officers are coming out publicly and being quoted in the press. So, would you turn to that relevant page of your brief and read what it says?

Paul Pindar: No, no, I won’t go to the brief, and I know you guys love using words like “shambles” because it is a nice emotive term.

Q169 Mr Bacon: Only because of the way it was—Actually, I think this has been a very fruitful dialogue for the most part and we have avoided colourful language, but I only used it because that is how it was described to me.

Paul Pindar: First and foremost, I think it is probably best to work off data that extrapolate from more than a sample of one. I apologise for the fact that this individual has not had a good experience.

Q170 Mr Bacon: I was not only working off a sample of one. The sample of one is what drew it to my attention—I am aware of the dangers of working off anecdote—but I then did some research on the subject and it wasn’t from the sample of one that I got the figure of 35%, and there has been a lot of attention paid to this recently.

Chair: Let me help you with a few figures. In the three months to June, 367 Territorial Army recruits were enlisted against a target of 1,432.

Mr Bacon: I was talking about Regulars, by the way.

Chair: Okay. The predication against an overall in-year target is only 50%. If you look at Regulars, 3,259 hopefuls attended Army selection interview days, compared with 5,042 the previous year. For officers the decline was steeper. Only 195 were sent for selection interviews, compared with 379 the year before. People signing up online were simply getting lost in the system.

Mr Bacon: That is what happened to my constituent’s son—he was lost in the system.

Paul Pindar: Okay, so let’s take a step back. The Army recruitment process was outsourced. Capita was the successful bidder. As a consequence of the outsourcing, the taxpayer has saved 50% of the cost of what recruitment was before. So to put that into context for you, Army recruitment—

Q171 Chair: I hate to stop you there, but my understanding is that 1,000 soldiers who were supposed to be taken off recruitment and be able to spend their time on the front line have now had to be transferred back to recruitment because you are not performing to the contract. That is my understanding.

Paul Pindar: Your understanding is incorrect and if you will let me answer the question—

Q172 Chair: It is incorrect to what extent?

Paul Pindar: It certainly isn’t anything like 1,000.

Q173 Chair: What is it? You can’t say it has cost less if soldiers who were previously—Maybe you will give us the correct figure that you have got.

Paul Pindar: We were awarded the Army recruitment contract and as a consequence of that the taxpayer has saved 50%. To put that into numbers, the service that was costing £100 million a year is now being provided for less than £50 million a year. If I give you the circumstances under which—

Q174 Chair: That is not true.

Paul Pindar: It is true. If we give you the circumstances under which Capita took over—these are not excuses because I am going to go on and tell you what we are now doing. The circumstances that we took over were, first, we had a strongly improving economic situation in this country and if you look at employment statistics, it is a far harder situation to recruit into the Army when the economy is recovering. That has been one disadvantage. Secondly, and I am not being flippant saying this, we also have a disadvantage that we have no wars on. Soldiers like to join the Army when there is something for them to do. Again, you can pull faces at me, but it is factually true. Thirdly, and again I am not doing this to apportion blame, we were to be provided with a working IT system to help us with recruitment when we started. The IT system that we were to be given had not actually been delivered. We had gone into a contract that made the assumption that that infrastructure was in place, and it was not.

Q175 Mr Bacon: I have a big sign—I am not making this up—above my office door in Westminster and another in Norfolk, and they both say the same thing, “Never assume”. What due diligence did you do before going ahead with this to establish that the putative IT system, if I can call it that, was a real one?

Paul Pindar: You can do as much due diligence as you like on an IT system—

Q176 Mr Bacon: You can go and look at it and see if it is running and working, surely.

Paul Pindar: Which we did do due diligence. We also received a lot of assurances regarding what the condition of that system would be, but the fact remains that those assurances were not seen through. There has been an independent report that has been written looking at Capita’s role in Army recruitment and I would be very happy for that report to be provided to you. I would not use the word “exonerated”, but I would say that Capita has been given a pretty clean bill of health in the contribution that we have made. The most important thing to say in all of this, however, is the future and not what has happened in the past.

Q177 Mr Bacon: It is important that you have got all of that on the record because in most of these cases, there is a lot more to come out than has necessarily yet come out. It sounds to me like the client side has got some answering to do as well, and doubtless we will want to hear more about that in due course, but what about people being lost in the system? This is some fairly basic administrative stuff. We fought the second world war before most of, if not all, the IT that currently exists had been invented, and all the recruitment—and it was millions of people, not an Army of 80,000—was done with card indexes, letters and snail mail. Why is the basic stuff of people being lost in the system being allowed to happen?

Paul Pindar: I have just given you the reason why it has been allowed to happen, and that is that the IT infrastructure that we were expecting to inherit has not been there.

Q178 Mr Bacon: But for the numbers that you are talking about, could you not have done it with a PC, a spreadsheet, a quill pen and a postage stamp?

Paul Pindar: I’m afraid that the world has moved on a little bit from that. We are talking about tens of thousands of applicants.

Q179 Chair: You are not talking about tens of thousands. In the first four months of the Capita contract, 3,259 hopefuls attended Army selections compared with 5,000. Again, for officers, where the decline was steeper, 195 were sent for selection interviews compared with 379. This is not hundreds of thousands.

Paul Pindar: Those statistics are very interesting, but they do not actually say the number of people that have approached us with an initial enquiry. We receive literally hundreds of calls a day and people trying to access the internet. Those might be the people that ultimately sign up, but they are a small proportion of those people who express an initial interest.

Q180 Mr Bacon: Was the spec for the contract that you were invited to tender for—you mentioned that there was a big cost saving from £100 million to £50 million—one where the MOD said to you, “We want you to do this and here’s how we want you to do it. We want a web-based solution so that it will save money,” or did they just say, “We want you to do this and we want it to cost x amount less, so tell us how you are going to do it.”? How did it work?

Paul Pindar: It was a process that we actually worked on with the MOD for two and a half years. It was a collaborative process where we designed the solution, worked with the MOD, and we took their feedback at various stages through the process. It was one where the MOD were fully aware of what we were doing and we designed with them.

Q181 Chair: Can I ask you a number of questions? You said that there aren’t 1,000 soldiers working on this contract now. How many are there?

Paul Pindar: I don’t have that number at my fingertips today.

Q182 Mr Bacon: Can you get it for us?

Paul Pindar: We can certainly get it for you.

Q183 Chair: Well, the figure I have here is that Capita says 1,000 and MOD says 900, so it is surprising you don’t assert that. I have two other questions on this. The original contract was £40 million a year and that was before the decision was taken to increase the number of Army Reserve soldiers. How much has your contract gone up by to cover that?

Paul Pindar: It will be a fairly modest amount, but again I do not have that number at my fingertips.

Q184 Chair: Will you let us have that figure?

Paul Pindar: Yes, we can do that.

Q185 Chair: Can I ask what penalties there are in place if you fail to deliver the recruitment target numbers?

Paul Pindar: Again, I do not know exactly what the penalties are, but our expectation is that we will not fail over the long term.

Q186 Mr Bacon: What do you call long term?

Paul Pindar: What we have done in response to the situation is, rather than work and blame other people for failing to deliver what they have done, we have gone back to the MOD. I have personally met with Philip Hammond, and we have explained to him an alternative plan where Capita is now going to take responsibility for the IT infrastructure, which is not actually our responsibility. We are also now building a web-based service from scratch. That will go live in January. We are expecting that the recruitment numbers will increase very sharply. The reason for that is because we are taking responsibility for making sure that it is a success; we are not sitting back and blaming other people for the things that they have not done.

20 November 2013 G45, Capita, Serco and Atos

Q187 Chair: Have you incurred any penalties so far—financial penalties?

Paul Pindar: Whether they are financial penalties or not, the contract is not performing in the way that it was anticipated to perform, because we are actually doing far more than we were originally anticipating that we would do. Again, in the spirit of working in partnership with the Army, for example, we have committed millions of additional pounds to the marketing campaign, to ensure that we create more activity and get as many of the recruits through the door as we possibly can.

Q188 Mr Bacon: You mentioned that you have been working closely with the MOD for two and a half years. That was started when, up until when?

Paul Pindar: The contract would have gone live—

Mr Bacon: In March this year.

Paul Pindar: Yes, in March this year.

Mr Bacon: So two or two and a half years prior to that.

Paul Pindar: Correct. That two and a half years was when the initial discussions took place about the outsourcing of the Army recruitment.

Q189 Mr Bacon: It just sounds surprising if that is the length of time you were working closely with the MOD on this—that, collectively, together, you have managed to come up with something that has produced startlingly poor results. You are now having to rescue it, by the sounds of it. It does not sound like a model at all. In the meantime, my constituent is still wandering around in the ether unattended to and, from what I have learned this afternoon, he might not be interested any more—you may have lost quite a lot of people.

Paul Pindar: If you would like your constituent to e-mail me, we will make sure that he is very far from the ether and that he is well looked after.

Mr Bacon: Thank you.

Q190 Austin Mitchell: I wonder if you are not all too big. With your scale now, you really are the new oligopoly. You have grown like Topsy over the past decade. You are covering too wide and multifarious an area, from Boris bikes and Grimsby schools to prisons or whatever—anywhere you can make a bob or two.

This wide coverage of issues—the scale—must mean, to me, that the structures are not adequately controlled from the centre. The centre does not always know what is going on in an organisation that is so big in scale and so wide ranging. That is a weakness when it comes to accountability and ensuring that we get the best possible terms out of contracts.

Alastair Lyons: The two do not need to go together. The fact that you have a large, diverse organisation does not mean that it has to be a poorly controlled organisation. The challenge for my business, being a large, diverse organisation, is that we do have in place the control structures, which provide that visibility and assurance, to ensure that if there is an early issue, it is detected early and acted on.

We had an independent review done of our systems of control by one of the big four accounting firms over

the course of the past three or four months, since those issues transpired. The accountants told us, “Yes, you have got a good basis as a framework, but there is a lot that you can build on—on what you have—in order to provide exactly that level of control and transparency.” That is what we now need to do.

Q191 Austin Mitchell: But you yourself have got so many directorships and chairmanships, I am surprised that you even find time to go to the Serco offices—with so many responsibilities.

Alastair Lyons: I assure you that I am spending a lot of time at Serco offices at the moment. But it is not important what I do as a non-executive chairman; what is important is what our executive management do—that we have the right people, with the right spans of control.

One of the reasons why we have split our UK division into two—a UK Central Government division and a “wider public sector” division—is so that we can concentrate that focus, particularly in UK Central Government, so that we have a team that directly face off against the Crown Representative to provide exactly that visibility and transparency that you are talking about.

Q192 Austin Mitchell: Does that go for the others? Mr Pindar, does it go for you?

Paul Pindar: All these things are a range of issues around the culture within the organisation—the processes, the structure, the quality of the people and the leaders you have. We have 62,000 people in the group and, from our perspective, we think that we have a flat structure between people at the top of the organisation and people at lower levels. I feel comfortable that the board of Capita is—

Q193 Austin Mitchell: You are satisfied that you have sufficient central control?

Paul Pindar: I am very satisfied that we sufficient central control for a business of our size, yes.

Q194 Mr Jackson: This is a genuinely good and positive Report. Although there have been some spectacular errors and mistakes, such as translation and interpretation for the Ministry of Justice, generally the contracting out of public services to the private sector has been a success and there is, to an extent, cross-party support for it. I have a general question: where do you see this going next, looking forward, in terms of what you will bid for?

For instance, at Peterborough prison now we have a social impact bond that is pulling together non-state players to tackle rehabilitation and to try to prevent recidivism among prisoners. Given your track record, what sort of interest do you have in being involved in that kind of project—quite a chunky, long-term project, without quick wins? Are you minded to offer your support with the voluntary sector in that sort of thing?

I have to declare that I am a big fan of Peterborough prison, which I think has been a great success as a private prison. Are long-term, difficult areas like rehabilitation of offenders the kind you are going to get into?

Alastair Lyons: It is not so much a case of getting into them.

Mr Jackson: Well, to continue or consolidate, then.

Alastair Lyons: We are already in that work. Doncaster prison, which we have responsibility for, was let on a payment-by-results basis. We work with voluntary service organisations, exactly as you say, and are working with two leading charities, Turning Point and Catch22, in order to rehabilitate offenders.

A material part of our revenue is dependent on our success in preventing offenders from reoffending; they have not to reoffend for six months after they leave prison. It is interesting that Doncaster is the lowest cost male prison in the UK, so you can be innovative and seek to deliver against very important social objectives while meeting the Government's cost objectives.

Q195 Mr Jackson: But do you scrub your face financially doing that? That is my question.

Alastair Lyons: Sorry?

Mr Jackson: Does it scrub its face financially for you? Reputationally it is good for you—that is all very well and I accept that—but does it make any money? That is what your shareholders will be interested in.

Alastair Lyons: Absolutely, yes. We have to deliver a return to our shareholders and that contract is delivering the level of margin that it was bid on.

Q196 Mr Jackson: Does anyone else have a view on these issues?

Ashley Almanza: Yes. We are in the business already and we would like to continue to be in that business. Whether by our own means or by bringing in the voluntary sector, providing purposeful work for prisoners, for example, is part of rehabilitation and that brings financial reward anyway, because you tend to have a more stable establishment and so can perform better against your KPIs under the contract. So it is financially coherent as well as socially desirable.

Q197 Mr Jackson: Will you be bidding for the short sentence offender rehabilitation?

Ashley Almanza: We have not made a decision on that yet.

Q198 Meg Hillier: That brings me to something that concerns this Committee. You are all big enough to bid for pretty much any Government contract. You have the expertise to do that, but some of the SMEs that some of you work with simply couldn't even reach that threshold, even with G-Cloud and so on. When you bid, how important is it that you already know the business and have in-house expertise?

Ursula Morgenstern: From our side it is one of the key qualification criteria—do we have that expertise? It is a very competitive landscape. There are four of us here today, but there are many more competitors out there. You really need to show that you have a differentiator and you understand the business.

Q199 Meg Hillier: Do you think that makes a difference and that Government are more likely to

give you the contract if you understand the business already?

Ursula Morgenstern: That goes for both the private and the public sector. You need to demonstrate that you understand the business and that you have an area of expertise and a solution that is not only value for money but stands out as well. That goes for the private and the public sector.

Q200 Meg Hillier: Mr Lyons, or any of the others, have you bid for contracts for which you did not have any experience?

Alastair Lyons: We have certainly in the past taken on contracts where we had not previously done that type of work. Before we do that we seek to bring in expertise to the company to ensure that we know what we are bidding for and how we go about delivering the targets within that particular contract. With a lot of contracts, obviously, you take the technical expertise with the contract, because you are taking it out from, say, the public service. We did not have 5,000 nuclear scientists when we moved into that line of work. But it is important that you are an informed purchaser of services.

Ashley Almanza: It is crucial that we have that already existing capability that is being transferred across. In some cases recently, we have looked at partnering with other providers to ensure that together we have the capability.

Q201 Meg Hillier: You mean bidding together rather than buying them in afterwards.

Ashley Almanza: Yes, correct.

Q202 Meg Hillier: Mr Pindar?

Paul Pindar: Exactly the same answer.

Q203 Meg Hillier: You didn't know much about hiring interpreters when you took that on, did you? But I think we will come back to that next week.

Health commissioners have told us that they worry about legal action if they do not tender a health contract. Some of you work in health. One contractor—Serco, I think—told us that if health commissioners decided not to tender a contract in their remit, they would not take legal action or sue. If you were not asked to tender for a big health contract, would you want to take legal action against the commissioners?

Paul Pindar: From our perspective, never. We are not a litigious organisation. If you get to the point where you have to sue a customer to do something you probably don't want them as a customer. It's not the greatest way.

Q204 Meg Hillier: So, never. That is on the public record. That is very helpful.

Paul Pindar: It is not the greatest basis for a relationship.

Q205 Meg Hillier: They are all frozen with fear about lawyers. Maybe we could get the others to go one by one, saying the same.

Ashley Almanza: We assume generally—and I take your caution from earlier about assuming things—that

20 November 2013 G4S, Capita, Serco and Atos

customers obey the law. I agree totally with Paul that suing a customer before you have even done any business does not seem like a winning formula.

Mr Bacon: We had a Deputy Prime Minister who used to hit electors.

Q206 Chair: I just need to cover a few issues that we have not covered. The first goes back to the tagging issue, where you held up your hands. Can I take it, on the back of that, that if similar issues come to light over the next year or so it will be fair to conclude that it will then become a responsibility of group senior management? In this instance you did not know, but in future you will.

Alastair Lyons: Absolutely.

Ashley Almanza: It already is.

Q207 Chair: Okay, thank you. Can I now deal with an issue about transparency? We have talked helpfully with you about open book accounting and access by the NAO. What are your views on FOI provisions?

Alastair Lyons: From our perspective, we would be completely happy to co-operate with FOI being extended to our own contracts.

Paul Pindar: We already comply. Provided we are not doing anything that offends our client—which ultimately we would need to check—but apart from that we already comply.

Ashley Almanza: I have a similar answer. It tends to work that we go to the client. I don't know of any cases where we have not been able to provide information.

Q208 Chair: To put it into context, MPs put in questions and are often told they can't have a reply because of commercial confidentiality.

Ashley Almanza: I don't have the full history, but generally what I have seen is that we reply saying that we are happy to comply, that we need our client's permission and we are seeking that permission. Then we go to the client.

Q209 Chair: So you are saying it is an issue for the Departments.

Ashley Almanza: We have to go back. Under the contract, we have to go back to the customer.

Q210 Chair: We had real trouble with DWP. Ms Morgenstern.

Ursula Morgenstern: We normally work with the DWP because that is the contract where we come across freedom of information requests and it is normally going via the Department.

Chair: Okay.

Q211 Mr Bacon: On the subject of the use of the words "commercial confidentiality", we have found this often for years. It is the Departments that are saying it. An investigative journalist who writes about the computer industry and consultancy once said to me years ago that, in his experience of talking to suppliers, they were far less concerned about commercial confidentiality than might be supposed. Everyone knows everyone else in the industry and people have a rough idea of each other's margins, and

anyway people are circulating around from company to company every few years.

It is mainly the Departments that are concerned about it and they are certainly the ones we hear it from. Mr Pindar, you were nodding. From what we have heard today, is that a fair characterisation? You generally are less concerned about commercial confidentiality in the way that it is being prayed in aid by the Departments—not by you—than might be supposed.

Ashley Almanza: I would express a more cautious view than Paul's. I would say that we would be totally comfortable with, for example, the NAO having all our commercially confidential information. We would feel less comfortable about our competitors having, by whatever means, access to that information.

Q212 Chair: I think we understand that. Quite often it is used as an excuse. There are obviously some things that impact on competition, but quite often there are some pretty straightforward issues that we raise as Members of Parliament and we just do not get an answer. Commercial confidentiality is pleaded in aid.

Q213 Mr Bacon: It is prayed in aid in circumstances where it does not seem that plausible.

Q214 Chair: It is obvious where it would affect your competitiveness.

Alastair Lyons: I don't think I have anything to add to what has been said before.

Q215 Chair: May I ask about two other areas? Have all of you got former senior civil servants working with you? I am thinking of a case of someone from DWP who went to Serco: Alan Cave. Do you recruit a lot from former senior civil servants?

Alastair Lyons: We do, yes. Indeed, a large part of our business is made up of civil and armed forces personnel.

Q216 Chair: I know there are people who have come over on TUPE, but what I am interested in is the cadre of people who do the bidding for the contracts.

Alastair Lyons: We certainly recruit individuals who have an understanding of what our customer is looking for on contracts, in terms of where the scope of the objectives of that contract is moving to, as part of giving us the basis to be an informed supplier.

Q217 Chair: We have the same issue when we look at tax matters. We want a healthy exchange of views from people working in the big accountancy firms, but sometimes individuals can use information that they have garnered and won, particularly in Government, to gain advantage in the private sector organisation for which they are working. How do you ensure that that does not happen?

Alastair Lyons: Typically, there are controls within Government with regard to senior civil servants moving out, and there is a transparency as to what that individual who is working with us has previously worked on. So between what the Government themselves do and what we do, one would seek to control that area.

Ashley Almanza: More than 90% of our business is non-Government. Obviously we do not exclude former Government employees from the recruitment pool.

Q218 Chair: And ex-Ministers?

Ashley Almanza: I am not aware of any.

Chair: I am. I think you have one on your board.

Meg Hillier: Who?

Ashley Almanza: I am not aware of one. I would have to think carefully about that, but anyway, we do not exclude them. If they are prohibited, then—yes.

Q219 Chair: Have you got any ex-Ministers knowingly on your board? I think you have got one, actually. I think you had better go and check it.

Alastair Lyons: We don't.

Q220 Chair: May I ask about tax? I have two more questions. One is tax. I am sorry to come in at the end, but I wanted to cover all areas. To all of you, the contracts that we have talked about today are funded by the taxpayer. Therefore I think there is a particular onus on you to pay your fair share of corporation tax on the profits you make from the economic activity you undertake here in this jurisdiction. From the information in the Report, neither G4S nor Atos in 2012 paid any corporation tax.

Ursula Morgenstern: We made, I think, 3% profit before tax. Essentially we did not then qualify for corporation tax. We made significant contributions to the pension funds of our staff.

Q221 Chair: We are just interested in corporation tax. We often hear people say that they pay other taxes.

Ursula Morgenstern: We have significant pension obligations: 70% of them are defined-salary schemes from ex-civil service, and from our perspective, this will continue for the next few years.

Chair: I accept that point.

Q222 Mr Bacon: On that point, when people are TUPE-ed across to any of your organisations from the civil service, then the pension obligations come with them, basically?

Ursula Morgenstern: Yes. And they of course are defined-salary pension schemes.

Q223 Chair: Ms Morgenstern, figure 19 says does indeed talk about the deficit on pension schemes, but it also talks about the use of allowances for capital investment. That is where we see a lot of ways in which people take their profits from one tax jurisdiction to another.

Ursula Morgenstern: And we don't do that. These are investments back into the UK. We put all our commercial activity here. We tax all our commercial activity here. For example, we invested in further capacity in Scotland; we took on staff from RAF Kinloss when it was closing down to set up new sites in Scotland. We were investing further in our data centres here in the country. We were investing in some of the public sector contracts which are payment by results. That investment is part of—

Q224 Chair: I will tell you what I would be interested in. I had calculated you had a 5% profit level. It looked to me at a 5% profit level as if you could be paying around £33 million tax. I accept that is at 5% and you are paying less corporation tax. It is a crude calculation. You are paying less.

Chris Heaton-Harris: I am wringing my hands.

Chair: In terms of transparency, it is something that really drives people wild. If their money is being used to provide you with business, and therefore profit, it is completely and utterly beholden on you to act within the spirit as well as the letter of the law and pay your fair share of corporation tax.

Ursula Morgenstern: Which I fully agree with and when corporation tax is due we will pay it. But again, from my perspective, we will need to fund the pensions of our staff; we need to invest in continued businesses in this country; we have 10,000 staff and we need to keep them. We need to make sure that we can provide them with employment.

Q225 Chair: I understand all that, but I am particularly interested in what is written in our Report. I accept the issue about having to deal with the liability on pension schemes. There is also the issue of carrying forward tax losses. I would be interested in a note from you on that and I would be interested in how you are using capital allowances. It is certainly our experience in a hearing we had only a couple of weeks ago that that is something that tends to get exploited.

Ursula Morgenstern: We are very straightforward, so we can send you that information.

Q226 Chair: Okay. Would you provide us with a note? Mr Almanza, the same is true for you. You are not paying any corporation tax?

Ashley Almanza: We pay corporation tax when we have taxable profits. We pay corporation tax around the world, and we pay it by jurisdiction where we have taxable profits.

Q227 Chair: I understand that. This is why I talk about the spirit as well as the letter of the law. If I look again at what is said in this Report about how you get to the position where you do not pay corporation tax, there are again mechanisms that we all too often see. One is interest deductions on group borrowings—that is a mechanism that people like Starbucks use; statutory tax reliefs on specific items, such as capital investment, that is also used; and the utilisation of tax losses.

Ashley Almanza: I regard all of those as fair and they are scrutinised by HMRC. I know that you are principally interested in corporation tax, however I agree with you that what the taxpayer wants to see is that all the companies are paying what is due, and what is due under the law. I will make one final point. Last year we made £70 million profit worldwide. In the UK we paid £426 million of tax in total. Regardless of what the tax is, that went into the Treasury's coffers.

Q228 Chair: I know, but there is a duty. We all pay lots of tax: our VAT, our council tax, every other sort

20 November 2013 G4S, Capita, Serco and Atos

of tax. May I ask one final question? Were you all trained before you came to today's hearing? Did you receive training, Mr Pindar? Did you, Mr Almanza?

Ashley Almanza: I took advice from inside and outside, but I wasn't trained.

Q229 Chair: You took advice. You didn't pay for training?

Ashley Almanza: No.

Q230 Chair: All these guys that are around offering you their services? I thought I would offer them to you, take the proceeds and give them to a charity. Mr Lyons, did you have training?

Alastair Lyons: Similarly, I had some sessions with our PR advisers and our legal advisers.

Q231 Chair: When you talk about advisers, are those outside advisers that help you with your relations with Parliament?

Alastair Lyons: No, not at all. They are corporate advisers who do those areas for us in every aspect of our business.

Q232 Chair: So they are outside companies?

Alastair Lyons: They are outside companies, but they are not specifically parliamentary-focused.

Q233 Chair: No, they are outside companies, so you paid them for that advice.

Alastair Lyons: Yes.

Q234 Chair: Did you pay some outside advisers for advice?

Paul Pindar: Who are you looking at?

Chair: Both of you.

Paul Pindar: The answer is no.² I am just wondering whether you think we should have done.

Mr Bacon: You can just buy my book; it's only £11.99.

Q235 Chair: I was going to give it with a donation to the charity. What about you, Ms Morgenstern?

Ursula Morgenstern: I definitely was well briefed by our team, but also by the companies we are using in the PR arena. It is my first time and this is a very important meeting. I took any help I could get.

Q236 Chair: And did you have to pay for it?

Ursula Morgenstern: We have long-term contracts with the companies, so not specifically.

Q237 Chair: This has been a really positive session. We see this as an important area of our work. I will just say what I said at the beginning: this is about our being able to follow the taxpayer's pound to ensure both value for money and probity for the taxpayer. I see it as the beginning of a continuing conversation. I really appreciate the fact that you all voluntarily co-operated with the NAO to enable this session to take place. Thank you.

² Note by witness: Mr Pindar was inadvertently wrong in making this response. Six hours of external research and advice was received and paid for by the team briefing him.

Monday 25 November 2013

Members present:

Margaret Hodge (Chair)

Guto Bebb
Jackie Doyle-Price
Chris Heaton-Harris
Meg Hillier
Mr Stewart Jackson

Fiona Mactaggart
Austin Mitchell
Nick Smith
Justin Tomlinson

Amyas Morse, Comptroller and Auditor General, National Audit Office, **Gabrielle Cohen**, Assistant Auditor General, NAO, **Keith Davis**, Director, NAO, and **Marius Gallaheer**, Alternate Treasury Officer of Accounts, were in attendance.

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL

Managing government suppliers (HC 811)

Examination of Witnesses

Witnesses: **Stephen Kelly**, Chief Operating Officer, UK Government, **Bill Crothers**, Chief Procurement Officer, UK Government, **Les Mosco**, Commercial Director, Ministry of Defence, **Vincent Godfrey**, Director of Procurement, Ministry of Justice, and **Richard Douglas**, Director General of Finance and the NHS, Department of Health, gave evidence.

Q1 Chair: Welcome. Apologies for being a little late; we had to discuss some issues among ourselves. I am sorry about that. We have a lot to get through and you are a big team in front of us today, although I think many of the questions will go to Stephen Kelly and Bill Crothers. Short, direct answers would be very much appreciated.

We are going to deal with both Reports: the Report on how you manage, and the Report we considered last week with the suppliers. You may hear references to both. We thought we had a positive and good session last week with the four biggest suppliers. If you look at the totals that the NAO put forward, probably about half of Government spend on supplies and services now goes through private contractors. This is a hugely important issue for this Committee, on the basis of both VFM and accountability.

Last week, we thought we secured some rather good commitments from the four we saw on three issues. One was open-book accounting; the second was open access by the NAO to all the contracts that companies have with the Government; and the third was freedom of information. I do not know whether you picked up on this, but I hope you did. Did you?

Witnesses indicated assent.

Chair: I hope that you are familiar with all this. These are views that this Committee has, for a number of years, thought were important, as we have looked at the fragmentation of public services and delivery by private contractors. We want to know your reaction to the commitments we got from the private contractors.

Stephen Kelly: Obviously, we welcome both Reports and their conclusions. Some of the initiatives that Bill and our Minister, Francis Maude, have initiated with industry are very much towards improving supply management, engaging with a partnership and being specific about the different segments of the marketplace. Historically, we have treated the market homogeneously. If you cast your mind back to 2010,

you are probably all aware that the marketplace, in terms of our data, was very fragmented. We had a long way to go, and we initiated, at that time, under our Minister, a cross-Government effort to raise our game. You could probably argue that some shock treatment was applied to the system at that time, and that there was reset with some of the suppliers.

What we are looking to do now is ensure that the second phase of the programme really addresses a couple of things: us becoming a better, more intelligent, smarter customer, continuation of our better data, better management of contracts—perhaps we will cover that in this session—and treating the marketplace more heterogeneously. The construction industry is very different from the FM market, which is very different from the people you interviewed last week about the outsourcing marketplace, which is very different from IT.

Generally, we welcome the statements made last week by the three chief executives and the chairman from industry. We have started a process with industry to encourage it, around this agenda, to ensure that greater transparency is associated with the suppliers.

Q2 Chair: Good. Encouraged or insisted on? There were three issues, and I want your view on all of them, and a further one, which Paul Pindar raised last week. One was that there should be open-book accounting.

Bill Crothers: Why don't I start with that? In a recent sample of large contracts, about a third were open book, although most of the open-book clauses were not used. What we have is a right, but for some reason, the Departments were not enacting the open-book clauses.

Chair: I am sorry, but I am finding it difficult to hear you.

Bill Crothers: From a sample, a third of our large contracts were already open book.

25 November 2013 UK Government, Ministry of Defence and Department of Health

Q3 Chair: We want 100%.

Bill Crothers: Absolutely. However, for most of that third, the Departments were not actually using the clauses that they already had.

Q4 Chris Heaton-Harris: Why was that?

Bill Crothers: We do not know. We have just found that out.

Q5 Chris Heaton-Harris: It is something that has been encouraged for a reasonable period of time.

Bill Crothers: Absolutely. It has been this Government's policy to have all large contracts be open book. We are developing a model contract—a standard contract across Government—and open book would be in there.

Q6 Nick Smith: Have you asked the Departments?

Bill Crothers: We have only just found this out.

Q7 Chair: Are any of the Departments present hostile to open-book accounting?

Richard Douglas: No.

Q8 Nick Smith: Mr Godfrey, have you been looking at these accounts?

Vincent Godfrey: Yes, we have.

Q9 Nick Smith: Historically?

Vincent Godfrey: Yes, historically. I agree with Bill that it is not uniform across all of our contracts, but we have increasingly been auditing all of our accounts. We have recently audited all our major contracts.

Q10 Chair: I would hope that you are always auditing. I would expect contracts to be audited consistently all the time, over time. This is a different point.

Bill Crothers: The point that I want to make is that we need better capability.

Q11 Chair: Can you say yes or no to this? Will you be including a requirement for open-book accounting in the letting of public contracts by the Government or their agencies, including local government and health?

Stephen Kelly: Effectively, Government policy is pushing transparency aggressively.

Q12 Chair: I asked you for a yes or no.

Stephen Kelly: The new model contract that we have in place will have open book as a requirement.

Q13 Chair: For everybody?

Bill Crothers: For central Government. Our remit is central Government only.

Q14 Chris Heaton-Harris: Would you build capacity in central Government, so that people actually utilise what is in the contract?

Bill Crothers: That is the point I was making. We need standards. We need to ensure profit. The Report is consistent with that. We need to ensure that people understand the information that they are getting and so on.

Q15 Fiona Mactaggart: One thing that we heard from the companies last week was that they felt that the officials with whom they dealt were not sufficiently senior. Is that something that we are doing something about?

Stephen Kelly: There are probably two points there. I would not hide that we have a big job to do, in terms of building the capability. It is easy to say "open book", but there is some science in the interpretation of net margin and allocation of overheads, and we need some accountants and finance people on our side of the table. We need to raise our capability significantly to manage open-book relationships, candidly.

Secondly, I absolutely agree about having the most senior level for the material contracts; I think that they said, in answer to whether they would expect the CFO and CEO to be involved in the private sector, "Yes, you would." I bet that a CEO on the other side in the private sector would say that, for material contracts, the highest level of the organisation should be involved. The people whom you are looking at now should therefore be involved in some of these material contracts.

Q16 Jackie Doyle-Price: So, in future, if an accounting officer lets a contract and does not have open-book accounting as part of it, we can say that they have not fulfilled their duties under your regime.

Bill Crothers: Yes. There is a materiality point. This is for large, complex contracts.

Q17 Chair: I think we have to get back to non-central Government, because central Government is only £40 billion out of the £187 billion.

Stephen Kelly: Bill and I have some authority for central Government, but more in an advisory function, and we are very respectful of that. The Departments and the accounting officers have accounting responsibility within the Departments. In the wider public sector, if you break out the £187 billion, we have some £50 billion in health and £80 billion-odd in local government, which we can help to influence—there is some good joint work going on—but that is not our remit.

Q18 Chair: Mr Douglas, are you going to insist on it for all your trusts?

Richard Douglas: For the major contracts, were it appropriate, then yes.

Q19 Chair: Yes?

Richard Douglas: My only pause is on the £50 billion, which includes lots of things. It would include branded drugs spend, where we have a totally different type of relationship, because it is the pharmacological industry. For the types of contracts that are being talked about here, if that is a position that central Government takes, my view is that we would put that into the standard contracts for the NHS as well.

Q20 Chair: What we might usefully do is write to DCLG, because it represents £84 billion, to see what

it will do with its contracts. Can we do the second bit, which was open access by the NAO?

Stephen Kelly: Just before we do, we have got some activities going on with the NAO where I think the process is working as a cross-Government review, which you are aware of. NAO are having an oversight of that. Actually, I think it is probably appropriate to let that process land, do some lessons learned about that, see where that takes us, and involve our Ministers, in terms of how we go forward. I think we are breaking ground here.

Q21 Chair: Parliament and, through Parliament, the taxpayer need some assurance. Open accounting will help your Departments manage better if they get the capability, as everybody is saying. What you then need is a mechanism that allows Parliament, through the NAO, and the taxpayer to be certain. We will come to the detail, but quite a lot of this stuff comes through whistleblowers and so on. What we have not had so far—for example, when we did the GP contract—is the facility to go into the contract. Did we, Amyas?

Amyas Morse: No.

Chair: We need that.

Stephen Kelly: We are breaking some new ground, I believe, with the process that we are currently pursuing with NAO oversight. We invited in the NAO to do that process with us and, candidly—I think you can get a reaction from the NAO independently—that process is working well, but, no doubt, we can make improvements, and it is probably worth letting that process complete, as that is only weeks away, and then reviewing what improvements we need to step it up, in terms of supporting transparency.

Amyas Morse: I do not have a problem with that at all; I think that is a reasonable response. It is just worth spelling out, though, that we are not saying, “We want to look at each and every contract.” I would say that when there are instances when the Committee is trying to find out what is going on in a major contract, and the information available to it is not as good as it might be, we want to be able to use our investigative arm to find out what is going on. That does not mean that it will be appropriate in every case. It may be that somebody in an arm of Government is doing a great job already. In many cases, that is perfectly true.

A good example is the Ministry of Justice, which has been carrying out investigations; we have worked closely with it, and it has been in the lead. It is not a question of us developing eyes bigger than our stomach, but we think that there are times when the ability to come and report direct information to the Committee contributes quite a lot towards Parliament’s ability to hold to account.

Bill Crothers: I think that’s reasonable.

Stephen Kelly: Yes, that is reasonable.

Q22 Chair: Good. Paul Pindar suggested last week that Government should have the power to put third-party auditors in on any contract at any time, which is a similar sort of request, but that need not be the NAO, necessarily. Would you agree with that?

Stephen Kelly: Actually, our Minister hosted a round-table session for some of those CEOs, so he is already discussing these sorts of principles. One of the other areas that historically we have probably invested time on disproportionately—I will give you the context—is procurement, and you could argue that that has not always achieved the best outcomes. We have disproportionately devalued contract management over 10 years. That is where, candidly, the taxpayer probably suffered. I think we therefore need to reset. For some of these material, complex, large contracts, certainly the emphasis would be on us making sure that, on a periodic basis—probably annually—they are reviewed and the assurance is provided that, effectively, we are getting the service we require and saving the taxpayer money. In this case, we have kicked-off a process again where that has extended to involving third parties. In this case, actually, both suppliers concerned have given their consent, and that is a complete contract review for these suppliers.

Q23 Chair: Okay. I note that they have on tagging; it is just that we would rather take it wider. The final thing is FOI.

Stephen Kelly: What is the specific question?

Q24 Chair: At the moment, if you ask a freedom of information request—we all do quite often as MPs—what you get back is that it is commercially confidential, and therefore the information cannot be provided.

What was interesting last week was that the companies themselves said that they had no problem with providing the information pertaining to a contract, which was welcome. I wanted to get an assurance from you that, with their willingness to give, it is not you who uses commercial confidentiality to prevent MPs and others from accessing information on the delivery of public services through private contractors.

Bill Crothers: I think there is a question of whether it would be voluntary or mandatory. If it was to be mandatory, we would probably need to think about it outside here.

Q25 Chair: Why?

Bill Crothers: We just need to consult with industry. It is perhaps a burden on industry—

Q26 Chair: The interesting thing is that they were all okay, and they are the biggies.

Bill Crothers: That is right; those four were. It would probably be sensible for us to consult a little wider to give some advice to Ministers.

Q27 Chair: Where it hits me most is on DWP. You are desperate to get information about how the Work programme is performing in your patch, and it is always hidden behind, “You can’t give it. It is commercially confidential. DWP told us that you can’t have that information.”

Bill Crothers: The principle is we believe that this Government is the most transparent. Transparency is always the first place where Ministers go when we give advice. On that principle, we would look at it.

25 November 2013 UK Government, Ministry of Defence and Department of Health

There may just be reasons why we need to think about how, and whether it is voluntary or compulsory, because it can add cost.

Q28 Chair: I think Richard Douglas gave a little look. What is your view?

Richard Douglas: I didn't realise that I had given a little look. I will have to watch what my eyes do. From our point of view, if that is something that industry agrees with, it makes our job easier as well.

Q29 Jackie Doyle-Price: After last week's session, I was left with a clear view that the enemy of transparency was not the companies, but the Whitehall machine that was hiding behind commercial confidentiality, perhaps because it does not want to show its weak performance in managing contracts. I get what you say: this is the most transparent Government—they are definitely a force for transparency—but ultimately you are taking on the force of conservatism in the Whitehall machine. Where is the stick to force that?

Bill Crothers: Within civil service reform, there is a programme I am running called commercial reform. Reform is challenging by its nature. We are trying to do things that have not been done previously. We are absolutely not resisting the idea. I just think that it is sensible to consider it a little bit and see how we would do it. I absolutely would embrace the idea, because transparency is good.

Stephen Kelly: Some things we would take are encouraging. We have done research on where the US, Canada and Australia are with transparency. We are also looking at European countries. I think we are ahead, but we need to go further, with things such as GMPP, with which you will be familiar through the Major Projects Authority. Contract Finder now publishes 19,000 contracts. Generally supporting Bill's comments, the Government are committed to transparency. It is our job to work with industry, so it is respectful for us to talk to them. We were talking to the BSA and we plan to talk to people like the CBI to make sure that we continue on this path.

Q30 Jackie Doyle-Price: I think it is your Permanent Secretaries to whom you need to talk most.

Bill Crothers: We will talk to them, too.

Q31 Chris Heaton-Harris: I want to pick up on the Chair's point and ask Mr Crothers about the DWP and the Work programme specifically. I have two providers for my own constituency and the geographic area around it. Each tells me that it is doing particularly well and has given me its own figures, but they would each love to know how the other is doing. That would encourage a competitive atmosphere in this market, so I can see it only as a positive. However, when you talk to some officials in the Department, I get the feeling that they see giving out this information as a complete negative. As we got the feel from the people in front of us last week, there is no great fear of this transparency from the companies themselves, as long as it is on a level playing field that is open to all.

I understand when you say that you have to test the market slightly wider. I guess the only question, which we will come on to a bit later, is how that affects smaller companies—whether they would be affected more adversely than larger ones. With that caveat, there can't be too many reasons.

Bill Crothers: The only possible concern I have is deciding too quickly and it being a burden. Why would you possibly resist providing such information? I completely agree. I think it should be provided.

I listened to your discussion with the suppliers. They talked about information being withheld because it is commercially sensitive, and I think there tends to be a presumption of holding information back, rather than a presumption of everything being provided except that information that is truly commercially sensitive. I would agree with putting much more out into the public domain.

Q32 Meg Hillier: Would you want to see the companies do that themselves? I am picking up on what Chris was saying, but I have heard one of the companies saying privately that it would not mind putting out that information itself sometimes to defend its performance but, of course, the Whitehall machine and Government Ministers, perhaps politically, want to control the message, and that slows it down. Have you had any discussions about, say, allowing a prison operator, a tag provider or a Work programme provider to put out their own data?

Bill Crothers: If you go to the broader point, one of my key principles is that there should be much better knowledge within the system. Good competition requires perfect knowledge, and if there is knowledge about suppliers—their behaviour, performance and prices—and that knowledge is flowing around the system, competition will improve and everyone gets healthier. Not keeping information secret is the way to do that, so I have absolutely no problem with that.

Q33 Meg Hillier: You say that you have no problem with that, but is it official Government policy? Would Ministers be happy?

Bill Crothers: Transparency is the policy of this Government. The Minister for the Cabinet Office has been pushing very hard for transparency.

Q34 Meg Hillier: I know he has. He and Mrs Hodge are champions of transparency, along with the rest of the Committee. However, if you are the Home Secretary, the Secretary of State for Justice or the Secretary of State for Work and Pensions, everyone is on at you about a challenging policy—it could be any Government, let's face it—and the provider is getting hammered about a prison or something, and decides to release data to prove, as it sees it, its good work or its challenges, you might not be quite so happy. Is that just tough?

Bill Crothers: You have been there, so you know that it is difficult.

Q35 Meg Hillier: I would be in favour of as much transparency as possible, but there is a whole swathe of people in the political machine who are there to control the message. Are they on board?

Stephen Kelly: The reality is that we are on a journey, which I think started in 2010. In the first phase, some blunt instruments were applied to reset the marketplace, and that was necessary. We are now at a stage at which we need to be more sophisticated, but within that the Government's policy is very clear on transparency, and this is part of the journey. We are probably in the foothills with this area, and transparency will probably continue apace. In discussions with the CBI and the BSA, we will pick up on some of the things that came out of the supplier session last week. We want to reduce the burden, the red tape and the cost of bidding. Again, you heard some statistics on the cost of bidding, which is 1% or 2% of the total bid value. We want to have a light touch, but better information.

Q36 Meg Hillier: One of them talked about having 150 KPIs, I think.

Bill Crothers: Yes.

Meg Hillier: Are you working with Departments to cut down on that? Everyone wants their favourite performance indicators.

Bill Crothers: When looking at contracts across Government, we have looked at particular sets—as it happens, Serco and G4S—but we will infer more general messages from that. One of the things we have found is a theme that contracts are more complex than they need to be. There are many KPIs with which performance is not managed as well as it would be if things were simpler. We will look at that and make some recommendations.

Stephen Kelly: That is part of being a better customer.

Q37 Chair: Do any of the departmental representatives have any problem with FOI?

Vincent Godfrey: No.

Q38 Chris Heaton-Harris: Mr Mosco, I would have guessed that your Department has the most concerns about that particular area, for valid reasons. First, how do you feel about the questioning so far, as it were? Secondly, how do you feed that into the process?

Les Mosco: On transparency, the principle is good. I would want us to consult a bit more with industry, albeit that the four suppliers last week were all okay. We should, as Bill and Stephen have said, consult more widely, because I can see that there might be some companies that—

Q39 Chair: Give me an example of what could be a problem. I accept that MOD does not want to let out technical solutions on which you might be engaged, or something like that. That could be a problem, but it is as if the words “commercial confidentiality” are put up there and you immediately assume that people will move away. Where could that be a problem? Interestingly—sorry to interrupt on this one, Chris—the MOD more than others has a sort of oligopoly of companies with which it deals, and it spends megabucks—it is always overspending. In a way, openness is more—

Chris Heaton-Harris: It also deals with other Governments that might have other issues and are not on the same page as us.

Les Mosco: I think you asked me three questions there. On the first, one example of why a company might regard information as commercially confidential would be if it was loss leading on its pricing, for whatever reason. It might not want that to be made public, because all its other customers for the same thing might say, “Well, if you can sell it to x for that price, why aren't you selling it to me for that price?” I can see circumstances in which a company would want to keep that private. The second issue is that a number of our contracts have security issues around them. In some extreme cases, even the existence of the contract is not something that we would want to talk about. There will be some such cases.

On the third point about the oligopoly and the very large suppliers, who are overwhelmingly the monopoly suppliers on very big contracts for which there is no real competitive market, new single-source regulations arrangements are coming in to replace the rules that have been around since the late 1960s, which are colloquially known as the “Yellow Book”. That was a set of rules governing how monopoly suppliers operate and how you manage that when there has been no competition. That has been a form of open book going back to the late '60s, but part of the Bill, which had its Third Reading in the Commons last week, was to strengthen and refresh the single-source regulations for monopoly suppliers. That has very explicit and quite tough requirements in terms of open-book disclosure and access by others to the numbers. That really does go a long way down the path you have been describing.

Q40 Austin Mitchell: I think that we all agree that openness is desirable and that not having it causes many problems. I was surprised last week to get the feeling that the providers are happier with openness than Departments and local government, which seem inclined to use commercial confidentiality as a cover for their own failings—that is just a jibe in passing. Having got open contracts and information, are the Departments, and particularly local government, in a position to use it as an effective means of auditing performance on the contracts?

Bill Crothers: Let me give you an example. I looked at an open-book contract—I did a commercial review of the contract with the Department and the supplier. The contract was open book, so we should see the gross margin. I looked at the gross margin, and they had deducted depreciation to get to gross margin. You just don't do that. My point is that the relatively junior officials did not have the accounting experience to understand that that was a bad thing. The supplier was saying it had been fully open, but in my view, it was being somewhat disingenuous. You do not deduct depreciation to get to gross margin. My point is that we need open book, and some standards and capability, so that we know what we are doing and we are able to use the information. We need to use what we have and go much more broadly across more contracts.

Q41 Austin Mitchell: So you audit the rate of profit, with the reservations that we have just heard about

25 November 2013 UK Government, Ministry of Defence and Department of Health

from Defence. You know when the rate of profit becomes excessive.

Bill Crothers: In the contracts that are open, you can see if profits are excessive, but you have to look pretty closely and quite often you need a specialism. You need to know what you are doing, because they are experienced, and often our guys are not, and the truth is that suppliers occasionally play games.

Q42 Austin Mitchell: Finally, is it not damaging to have lists of preferred bidders because that excludes a lot of people who might be able to compete and does not give you the full and fair competition you need to get contract prices down? Why have preferred lists?

Bill Crothers: I agree.

Stephen Kelly: It is not the simplest. I think there was some good work done on the first Report around comparison of the four companies. If you look at Capita, you see £3.4 billion turnover and £290 million profit before tax, but it is not just the comparison against the plc numbers. What we are looking to do in the second phase of this programme is to compare their margin analysis, first to get consistency and apply the same accounting standards, so we are comparing apples with apples, but also to compare division against division. So, if the company is working in the US with the Department of Defence or the federal Government, it would be really useful to compare the margins that they deliver against that customer with ourselves. Then there were some more sophisticated conversations around gain share, which becomes quite pivotal in terms of the interpretation and intelligent customer function on our side of the table, to make sure we are going in with our eyes open.

All I am saying is that it is not as simple as it sounds. The challenge for us, honestly, is that we need to raise our capability significantly on our side of the table.

Q43 Meg Hillier: Can I ask how long it will take? I know Mr Crothers; he and I worked together in the Home Office on some old contracts and new ones. Some of the old ones are just bad, and they are written in for a long time. So how long will it take for all the contracts—the bad ones—to run out, for the new ones to be in place and for the staff to be capable of doing open-book accounting and the proper management?

Bill Crothers: I do not think we have to wait. We can pick one of the segments that has probably the least competitive practices, and that is ICT—technology, IT, telecoms. Probably about 40% to 50% of those contracts will run out in the next 18 months, so there is a natural cycle. However, my view is that if a contract is bad and it has a bad clause, you don't wait till the end. We have enough influence on our side. We provide change requests and we do all sorts of business, so that we can negotiate those things into or out of a contract before it ends, and we have been doing some of that.

Chair: I was going to move on to tax.

Q44 Nick Smith: I just want to come back on capability. It seems to me that there are some unanswered questions about genuine concerns you have about capability to deal with open-book

accounting. You have talked about this issue; it seems to be a very big issue. So what measures are you going to set in train to raise the capability of the staff you have got, to bring in new staff, or to get the senior staff to concentrate on this high-level challenge around the profits of the suppliers you work with? What are you going to do about it?

Stephen Kelly: Maybe I will start there. There are probably three key skills that we need, and No. 1 is someone who understands the domain; so, someone who has lived in the world of BPO or IT. You talked about some of the companies last week making between, say, 5% and 10% net margins; some of these ICT companies are making 40% or 45% earnings before interest and taxes. So, some of the areas that we will focus on are the areas where, in the first phase, we have treated things more homogeneously, but we will get very smart around segmentation. So you need the main experience.

Secondly, you need financial management experience, and, thirdly, you need some contract management experience. Bill is leading a programme around commercial reform, which encompasses this. Bill, do you want to talk about what we are doing?

Bill Crothers: Briefly, we have announced previously that we have created an entity called the Crown Commercial Service at the centre of Government, essentially to manage all of that spend that is common to Departments. So, not tanks, not prisons, not hospitals, but that which is common. It is about £10 billion or £12 billion of the spend. We are actively recruiting for that. On Wednesday night, we will be having a recruitment seminar; 140 or 150 people are coming. We are looking for 80 or 90 people. Currently, we have open spots. We are recruiting commercial specialists. So we are just recruiting capability, and we need people who have the sort of experience that Stephen mentioned.

Q45 Nick Smith: You have told us about the “what” and the “why”; I am still a bit unclear about the “how”. It sounds like you are saying you need a cadre of 100 people that you can drop into this problem. Is that your assessment?

Stephen Kelly: I think, again, the Report highlights this new function that was established a couple of years ago, around Crown representatives. Most of those guys—like Ian Tyler, ex-CEO of Balfour Beatty, and Rob Wilmot, founder of Freeserve—are very experienced individuals. It is very clear that we need to build up that cadre, have them segmented around key business areas like BPO, ICT, telecoms, construction, and then support that process and the Departments with real competence to be able to achieve that. We have half a dozen new Crown reps starting soon, so this is very much work in progress.

Richard Douglas: Could I come in with my non-health hat on, as Head of Government Finance Profession? There has been a focus for those of us working with Bill and his team on how we develop finance and commercial skills, working together across Government.

I have a stream of work led by one of our DGs to help develop a programme of finance training, both for finance people and, critically, to get better financial

and commercial understanding across the wider senior civil service. I have mandated that training at the moment across the Department of Health. Every senior civil servant will go through that financial and commercial skills training. That is the sort of taster end of it, but we are trying to work with both professions together to get this capability right the way across Government.

Q46 Chair: I am going to talk a little bit about tax, and then I want to go back to control. You talked a bit about trying to get a real handle on understanding the profit levels. The Green Book, the Treasury guidance, is absolutely clear. It says that when the Government are deciding whether to contract with the private sector or deliver a service in house, Government should include the tax paid by contractors as a factor. There is a clear remit for you to ensure that, quite apart from my personal view and that of some others round the table that, if people are going to take the taxpayer's penny to make some money out of it, they have a duty to pay their fair contribution according to the profits they have made in the business they undertake in this jurisdiction.

When we looked at the four companies last week—there may be good explanations—two of them, G4S and Atos, paid absolutely no corporation tax, although both of them had £700 million-worth of business with us.

Stephen Kelly: First of all, I would say that in the summer some new rules were established, where all companies had to be compliant with their tax. What I think you are moving to is the spirit of implementing that, rather than employing exotic accountants to work in the Cayman Islands and such places. Candidly, there is only so much we can do. We apply the rules, and Bill is overseeing that to ensure that companies are complying with the tax regime.

Obviously, with these things it is complicated. There is multi-year depreciation, writing off against costs. We understand that, but we do encourage companies that deal with the Government to be responsible citizens. In September Bill wrote to the top 40 suppliers reminding them of our expectations around corporate citizenship. We are just receiving the returns around that. You might want to talk through some of that because it includes tax as well as apprenticeships and other important areas.

Bill Crothers: It is broader. As Stephen says, it is really hard just to have a simple rule: if you pay no tax, you don't get any business. It is not that simple. We had the rules that we put out which are compliance—essentially are you legal in tax—

Q47 Chair: "Legal" is very difficult to define, Bill.

Bill Crothers: This is a hard area, I'm sure we are in agreement. It is just hard to execute. We wrote to 43 suppliers and asked them for information on hospitality. We asked what they had spent on hospitality with the civil service; what number of new patents had they registered in the UK; what of the business they had with us was booked in the UK rather than overseas, and so on. We got replies from about half. That was two months ago—only half. Of that half, we need further discussion and more

information. It is not just about tax. We are trying to address this to ask, "Are you a good corporate citizen? Are you contributing to the UK?" I know that is not your particular point. At least we can talk around that and investigate some other aspects.

Q48 Chair: I was pleased to read in the Report that you are beginning to have a look at past performance. You have decided at last that you can have regard to past performance in deciding whether or not you award a contract again. I wish you well on that. I have always thought it was ridiculous that we did not do that, and I did not believe the EU rules that said we couldn't.

Will you have regard to this broader definition of corporate citizenship? You have talked about hospitality. We talk a lot about tax in this Committee. Will you have regard to that in deciding whether or not? I was thinking of the old PFI contracts we looked at where it was plain obvious that they were making an arm and a leg out of the contract, then taking most of it offshore and not paying any UK tax on it at all. I want to know how it is going to work.

Bill Crothers: There is a formal policy called taking past performance into account. It is surprising that it did not exist, but we put it there about a year ago. It is technical in that you have to take performance into account on a particular contract; so we look at a contract in defence, in justice, or in the Home Office, and that performance is documented by that Department and is then taken into account in the procurement decision by another Department. What you can take into account is somewhat prescribed. Generally, I think that we tend to be quite risk-averse and a little cautious. We tend to take a slightly different view—we should be looking at performance in the round. I will not say that that means we can take tax paid into account, because it is not that straightforward.

Q49 Chair: Does it mean you can't?

Bill Crothers: It is silent—it does not say that you can or you can't, but you can take performance into account. For example, you can take into account whether a supplier has been overcharging and whether a supplier is solvent or not; you could maybe take into account the example I gave you earlier of a supplier charging depreciation to get to gross profit, because that is disingenuous. I think we can take more into account than perhaps we have in the past and we need to take past performance into account properly, whereas before, we did not even have a policy on it.

Q50 Chris Heaton-Harris: Going back, lots of the contracts were very different to the contracts you are signing now. It is not an interest, because I no longer run the company, but I used to wholesale fruit and veg for a living in New Covent Garden market and one of my biggest customers was the American air force, and they insisted that you had the same price for a product for a month. It was a market, so the price went up and down: one day, I would be losing tonnes of money because I had agreed to make the supply, and the next day, I would be making tonnes of money, because there was a glut in the market. Contracts are way more

25 November 2013 UK Government, Ministry of Defence and Department of Health

flexible now. I am hoping that that fantastic, does-what-it-says-on-the-tin policy you introduced a year ago also means that you are being more flexible and modern in your contract approach as well, when looking at new contracts.

Stephen Kelly: Yes, I think that is fair. A departure that is probably welcomed is that pre-2010, there was a very binary view—either do things in-house or outsource them—whereas now there is more pragmatism to look at the business form and business structure of the best way to provide and deliver the public services. Recently, you have probably been aware of such things as MyCSP, which was a joint venture with Equiniti Paymaster, with some employee ownership. The good news is that one year later, service has gone up by 30%, the unit cost of the core administration service to the taxpayer has reduced by 20%, and over the life of the project, it will go down by 50%.¹ So we are now seeing some more intelligent models, looking at equity, ownership and what we need in terms of better public services for less money. There are smarter ways of doing these things. I think it was Mr Pindar last week, who talked about how to operate gain share. Again, having 150 KPIs is probably not a smart way to go, but you need that intelligent, smarter customer, and fundamentally you need to ask, “What are we trying to achieve here?” in terms of the service to citizens, but also the impact on the taxpayer and the other areas around corporate citizenship.

Bill Crothers: Could I briefly say that the most important principle, which the NAO Report mentioned, is who are we? We are the Crown. We are not a Department. What has happened traditionally is that suppliers have priced per Department and you get a range of 50, 60, 70, or 80 separate rate cards by suppliers. When we become the customer—we the Crown—we want to get rid of that and get one price for all Departments and use our commercial leverage. We are just redressing the commercial balance that we have lost for years.

Q51 Chair: Keeping on this point, you have said that you can take past performance into regard. We are bit iffy about whether you can take their contribution on tax into regard, but you might look at their hospitality—that is what I understood you to say. I would like you to take their tax into account, but have you ever, on past performance, sacked anybody?

Stephen Kelly: A company or an individual?

Chair: A company.

Bill Crothers: Have we ever stopped a contract?

Q52 Chair: And not used them again?

Bill Crothers: As a matter of fact, yes, but I am not sure we have not used them because of that.

Q53 Chair: Can you tell us who, and in what circumstances?

Bill Crothers: I think it is a matter of record that the contract on e-Borders was stopped because of breach. That is in dispute. The supplier—

Q54 Chair: Who is the supplier?

Bill Crothers: Raytheon. They dispute it; they say that there was not a breach, so there is an argument going on. In that case, we said there was non-performance, it was a breach, and the contract was stopped, but they dispute that.

Q55 Chair: So that is the one contract.

Bill Crothers: No, no, it is the one I can mention.

Q56 Chair: What about you guys? Mr Douglas, Mr Godfrey, Mr Mosco?

Richard Douglas: I cannot think of one off the top of my head, but that does not mean there have not been any.

Chair: You have been there a long time.

Amyas Morse: Chair, if it is helpful, we had a hearing on the cancellation of the contract for East Coast main line rail operations. Do you recollect?

Chair: That was before our time.

Amyas Morse: No, it wasn't. We were particularly impressed that the Department for Transport had had the gumption to take the action that they did.

Stephen Kelly: In the last fiscal year, I think—from memory—109² were put through the strategic supplier control processes established by this Government, of which nine were rejected, and many of those were contract extensions.

Q57 Jackie Doyle-Price: On that point, the contract for PIP assessments was awarded to Atos after there was a lot of intelligence about underperformance on the work capability assessment contract. Were you involved in any discussions with DWP when that contract was issued?

Bill Crothers: The contract was issued a few years ago.

Q58 Jackie Doyle-Price: But the PIP contract was issued earlier this year after there was a lot of intelligence about underperformance on the work capability assessment. If you are saying that past performance is taken into account, clearly it wasn't in this particular example.

Bill Crothers: I honestly cannot remember the timing. The policy became extant about 12 months ago, maybe nine. I am not sure when the PIP contract was awarded. It is the case that there is an obligation on Departments to take past performance into account, and they do that through requesting formal performance certificates.

Q59 Jackie Doyle-Price: The PIP contract was awarded earlier this year. That was after you said you were reviewing past performance.

Bill Crothers: I would be happy to check and write to you.

Chair: Did PIP go to Atos?

Q60 Jackie Doyle-Price: It did. Figure 10 documents it.

You had a review of the Atos management of the work capability assessment. That review took place after the contract was awarded to Atos, but this reflects concerns from a previous small audit. The Report

¹ Witness note: If the 3 year contract extension is taken up.

² Witness note: 104

documents that 41% of assessments did not meet the required standards. Typically, DWP's response was that that does not mean the recommendations were incorrect, which is classic DWP when it comes these things. This is what worries me. You talk a really good game, but it is not replicated across Government. Where's your stick?

Stephen Kelly: First, it was challenging getting that policy landed. During the course of last year, we received a lot of advice that was very risk-averse. The Minister was very clear that this policy needed to be enacted, and it landed at the beginning of this year. Regarding Atos, we have worked with the Department in the last eight to 10 weeks around those situations. Prior to that, I cannot speak for back in the spring, because I genuinely cannot remember, but we will write to you about the timing.

Q61 Chair: Do you want to say something, Mr Mosco?

Les Mosco: I wanted to answer the earlier question. I can think of a few cases where the MOD has cancelled contracts with a given supplier. The thing I would stress is that suppliers are often a curate's egg. They are good on one contract and bad on another, so you cannot, on the basis of one contract, assert, "This is a delinquent supplier; we should never do business with them." You have to look at the facts of the case.

I can think of another example where we had a supplier that had a couple of contracts that we were unhappy with, and a number of other contracts that were okay. In the MOD, because we are so large, we have a process for managing key suppliers, and what we did with that particular company was to bring them in and have a very serious conversation with them. We pointed out where they had failed and we pointed out that we thought they had some underlying problems, which they have now sought to address. The issue of dealing with suppliers who are failing definitely does need to be followed up, but you cannot assume a single failure is a sign of the terminal decline of the company. If you get some consistency, however, yes, you need to do something in a co-ordinated fashion.

Q62 Jackie Doyle-Price: It can be down to a poor customer.

Stephen Kelly: It can be. One of the things from the market review last week that we are very focused on is that we want a vibrant, competitive marketplace in the private sector to provide excellent public services and save the taxpayer money. The whole purpose of this is not things like blacklists, and so on; it is to get them back in play, and really to get them to step up and be unequivocally clear about our requirements.

Q63 Fiona Mactaggart: You were saying that you had only recently been focusing on the Atos contract. I do not know whether it is your focus, but I had the rather peculiar experience just three or four days ago of receiving a grovelling e-mail of apology from someone in the Department for Work and Pensions. They had said that Atos, as part of its bid, had stated that 75% to 90% of claimants would have no journey longer than 90 minutes, and they had to write me an

apology because that figure, which was repeated in about 10 different places in the Atos bid document, was actually 60 minutes. I am fairly certain that the DWP has been monitoring Atos on the wrong figure. I cannot imagine why they would have put 60 minutes in a parliamentary answer—not just some scribbled note—unless they believed in practice that that was what they were monitoring.

That causes me real concern that what is happening is that the reality that a company is committed to—in the same contract the company promised hundreds of centres in London and the south-east, but actually there are fewer than 100 centres—can be completely reinterpreted, as it seems to have been in this case, not in favour of my constituents who have excessive travel distances and who have to go upstairs in assessment centres despite their mobility difficulties, but in favour of the company. We do not usually see those documents, although I managed to get hold of this document. What are you doing to stop that?

Bill Crothers: That is new knowledge, and we cannot answer for DWP. What you have raised we should take away, perhaps. Let me talk about the process. We have a set of 31 strategic suppliers that do substantial business with us. We have a Crown representative allocated to each, who looks at the totality of the business across Government. That has never happened before. We meet on a regular basis every four to six weeks on a commercial review board, and we review the progress, the status and the performance of those suppliers and rank them "red", "amber" or "green". If they are materially and systematically poorly performing, they become "black", which means that they are high risk and we take special sanction with them. We get a report from the Departments, and it is not a passive thing; we ask the Department how they are performing in each of the contracts. We put all of that into the assessment of whether they are "red", "amber" or "green". When I have looked at contract management across Government, we could do better.

Q64 Fiona Mactaggart: What colour is Atos?

Bill Crothers: I cannot tell you. I cannot remember, and it would probably not be appropriate to tell you. The purpose of the process is not to name and shame and embarrass; the purpose is to tell the supplier how they are doing so that they can improve. We tell them what colour they are, and it works as a really good sanction because they do not want to become high risk, and we see improvements. The contract management in a number of our large contracts could be better, however. As Meg says, there are complex KPIs. The people who are managing contracts are sometimes too junior. Change requests happen at levels which are junior, or complex, or whatever. On that particular, if you would like us to take it away we will, but we cannot speak for DWP, because I don't know the contracts that well.

Amyas Morse: Stephen, going into your last comment about a vibrant competitive environment, to be honest, I do not think the record of nurturing a competitive environment is all that great. I say that because to be quite frank it is quite evident, even with those companies that we saw last week, who were very open with us and in many ways gave very good testimony,

25 November 2013 UK Government, Ministry of Defence and Department of Health

that the rate of growth that they are achieving is largely speaking through acquisition—not solely, but mostly non-organic growth. Therefore what is happening—and it happens in a lot of areas of Government supply—is that the Government stand by and watch consolidation of the supplier base.

I am afraid, as you know very well, if you are a supplier and you want to maximise profitability, you don't do it by having vibrant competition. You do it by having as little competition as possible. So you can't expect them to do this for you. I think there is a real challenge about whether we have sufficiently agile means of maintaining competition in these markets. I don't know what your comment on that would be.

Stephen Kelly: Amyas, I think you are absolutely right. Bill and I probably feel this sentiment. We are not here defending the record, because we have got tons to do, and we are in the foothills. What I opened up with, in terms of intelligent, better, smarter customers, and being a lot smarter around market segmentation—so treating the BPO market as very different from the IT market, very different from the big four and the consulting market: around the areas of public service provision around outsourcing, we have got a review just kicked off, to make sure we do get a vibrant marketplace.

A couple of, I guess, statistics give me some comfort, but also give me some fear. The good news is I think we saved overall £10 billion last fiscal year and we just announced we saved about £5.4 billion for the first half, unaudited. This programme probably cumulative savings are over £5 billion since the start of the Parliament. However, an additional £1.5 billion is being invested with the Government to SMEs. So there is G-Cloud, and the former Government CIO for the US announced at the weekend that he thought G-Cloud was probably leading the world around open procurement. What I would say on that is that there are about 1,200 SMEs,³ and 13,000 services. We came out last week with a digital framework. The issue—my worry—is: are we incubating a lot of great SMEs for financial consolidation? That would be to conspire against ourselves.

Amyas Morse: That is interesting, but can I come back to the direct point that you are often seeing small competitors winning contracts and immediately being acquired, and in some cases there is probably a contractual right on the part of the Government to oppose that, and they are not applying that right. Correct?

Bill Crothers: I agree. We have the contractual right typically to do that and I think we need to be very vigilant; and we are looking at one at least, at the minute where there is a takeover with a contract, with the company being taken over. We are looking at it.

Stephen Kelly: Yes, there is one specifically now where we are looking to enact the change of control provisions to prevent that happening. It is great having all these SMEs and doing another £1.5 billion, and typically most of them are UK companies; but you are absolutely right. I think it is very important for everybody in the Committee to take away that our end game is a vibrant market of big companies and small

companies; but companies that follow purely consolidation-acquisition—that doesn't make sense.

Q65 Chair: We are going to come to SMEs. I want to do a couple of questions and then I will go to Meg. The impression I got—it has come out of this questioning—is that your view is that the big four we saw last week are too big to fail.

Stephen Kelly: To fail à la banking crisis?

Q66 Chair: Well, we will go back over some of their performance, but they have now consolidated; they have all grown 500% in the last 10 years. They have become enormous. I think you have done a very good job at getting to grips with the IT, where there is more competition. However, for the other services we are looking at here you have the big four, which have done this 500% growth primarily through acquisition. Although one of them, Serco, has done it generically by getting more contracts, the others have all bought to acquire their market share and they are too big to fail.

Stephen Kelly: A couple of things. First, one of the problems this highlights is that from a companies point of view, if you continue to acquire companies, you have issues spreading the control environment that lead to issues associated with contract management, ethics and all that sort of thing.

Q67 Chair: Yes, but you won't get rid of them. You cannot afford to.

Stephen Kelly: Secondly, I think there is adequate provision in most of the contracts around step-in, and all Departments have been asked for contingency plans to ensure that, if what you are suggesting did play out, we are well catered for in terms of provision of Government services continuing.

Q68 Meg Hillier: With Serco, the prison contract was taken away from them and it is now in the public sector. So is it that, just like with the failure of the banks, the public sector is the last resort supplier? If they fail, don't worry because we will just step in.

Stephen Kelly: We have to acknowledge that we are where we are. The other critical factor around the strategy is disaggregation—making things smaller. For example, it is perhaps worth highlighting, since you mentioned that one, either prisons or probation, where we are looking to break things up into much smaller, manageable chunks. That could be done by business services, vertical or regional, to make sure that we are not dependent on just a few big companies.

Q69 Chair: So you mean to say you would have a “G4S north-east” or something?

Stephen Kelly: Do you want to talk to that, Vincent?

Vincent Godfrey: Yes. I could perhaps start with a pertinent example in electronic monitoring. Traditionally, and certainly since the inception of electronic monitoring in 1999, the contracts have been vertically integrated, so you would expect to see G4S and Serco providing everything in there. They own the equipment manufacturers, for example, and provide it as one end-to-end service. In the next generation of

³ Witness note: suppliers of which 84% are SMEs

electronic monitoring, we have broken it up into four parts. Although you might have Capita running a processing centre, we have different software and hardware suppliers. For example, where the hardware is concerned, that is actually a competition between three companies, not involving G4S and Serco. It did not involve G4S and Serco from the outset, and two of them are SMEs, which has brought in different types of technology and moved us into that. It is also worth talking about the rehabilitation competition—

Q70 Chair: Can I stop you on that? We will bring you in again on rehabilitation. I have had some representations—I know Meg has as well—from a lady from an SME that has been active in trying to get into your new contract. I think she has written to lots of MPs, and she said that it has been an absolute nightmare dealing with you guys. She did try to get into lot 2, which was the software. Buddi is the name of the company, and they were told that they could not win the software contract as it was too high risk to give it to an SME. Deal with that one first.

Vincent Godfrey: That is not true. Buddi competed—

Q71 Chair: I don't think she lies.

Vincent Godfrey: I was not suggesting that that was a lie, but we ran a competition, Buddi competed for the software, and they were not precluded on those grounds. They had the opportunity, they did compete and they are the preferred bidder for the hardware. As I say, other SMEs participated in that competition as well.

Q72 Chair: I have to say to you that Buddi were told that an SME could not win the software as an SME was too high a risk. That is what she actually said. Let me go on to what else she says. She gives evidence about how you set about the procurement. There was a PQQ on 9 February 2012. The preferred bidder was announced on 20 August 2013—that was 18 months later. Within that, for example, one request for information required her to fill 12 A4 boxes. It took four days, 20 hours each day, simply to print the documents. For an SME to do that is ridiculous. She then compares it with a contract in Michigan for similar equipment that they produce, where the PQQ, or their equivalent of it, gave a date of 26 June 2013 and the preferred bidder was announced less than five months later on 5 November. That is a shocking indictment of our ability to contract with SMEs when there is a non-contentious commitment across the piece to encourage SMEs into the market. Of course, she does say that her product—you can take this however you like—is much better than that of G4S. How do you respond to that? I have one more issue that she raised that I want to raise with you.

Vincent Godfrey: There are two parts to the answer. The time scale for procuring the next generation of electronic monitoring has been more protracted than we would want it to be. That is in part because the team that has been involved in the procurement has been dealing with issues that emerged in the early part of the year around billing with G4S and Serco. That has undoubtedly taken time to deal with, in terms of running the competition and resolving those issues. I

would agree that that has extended unduly the duration of the competition.

Q73 Chair: Mr Godfrey, with the greatest respect, more than 18 months as opposed to less than five months cannot be justified simply by referring to the trouble you have had with G4S and Serco. You cannot justify it on that basis, sorry. It does not ring true to me.

Stephen Kelly: Madam Chairman, on that specific point and with full disclosure, I spoke at an event on Friday and the lady CEO came up to me and said, "I would like a chat with you." I have not had time to follow that up and I commit to giving her a call and finding out what went on.

Q74 Chair: Let me talk about the final thing that she raised with me, which I thought was outrageous. She does think she has better equipment, but I am not judging that. She thinks that we have an absurd situation. She has been trying to compete with the tagging on police services up and down the country. She cannot even enter the competition because we have a statutory instrument that defines the responsible officer for providing the tagging equipment. That statutory instrument states that the responsible officer has to be either G4S or Serco. In a statutory instrument laid down by us in Parliament, we are deliberately preventing what appears to be a perfectly bona fide good SME from competing.

Bill Crothers: We should look at that. Presumably that is a statutory instrument that came from the Home Office and relates to policing.

Q75 Chair: Yes, it is for policing.

Bill Crothers: We should look at that. I am not aware of that, but it is worth looking at.

Chair: Perhaps you can write to us on that.

Q76 Meg Hillier: First of all, I think that G-Cloud is great, and I appreciate G-Cloud coming and talking to SMEs in Shoreditch. It is a start, but it is not there yet and I think we would all recognise that. I met the chief executive of Buddi a few months ago. I had followed the story in the newspapers—it is not just us watching this matter—and I use Buddi as a model for what will happen to other smaller companies bidding through G-Cloud or anything else. The *Financial Times* was rigorously following whether Buddi made the cut. A message has to be got out that government is open for business to SMEs. Even in my area, where there are lots of very innovative SMEs, there is a bit of scepticism. A story like that goes round very quickly and some of the start-ups think, "I'm not going to bother, because it is too complex." What is your message to them?

Bill Crothers: That is counter to our message. We will look at those examples. The message is that we are open for business and we want to do business with small and medium-sized enterprises, not just because its some form of altruism, but because it makes economic sense. Those enterprises are cheaper, more innovative and they often perform better.

25 November 2013 UK Government, Ministry of Defence and Department of Health

Q77 Meg Hillier: One of my local companies is Affinitext, which I am proud to have in Shoreditch—the Government helped support it in coming into Shoreditch. It has been very positive about the support that the Government have given. There is good and bad.

Stephen Kelly: We acknowledge everything. For an organisation of 400,000 people, the message sometimes takes a bit of time to land and to change behaviours. We are pushing ahead, but there will be many SME CEOs who will still either be cynical or be having bad experiences. Hopefully, if we get it right, those will diminish.

Q78 Meg Hillier: As you have Crown representatives, perhaps you need some SME representative.

Bill Crothers: We do. We have a Crown representative specifically for SMEs.

Q79 Meg Hillier: Perhaps we could have an event for them.

I want to ask a couple of other things. On this subject, you talked about probation and parcelling it up. What we understand about probation, which has been debated a lot in Parliament, is that there will be large-area contracts that companies with no experience of probation can bid for and then subcontract. Perhaps you are not the best person, Mr Godfrey, to answer that specific question, but pick it up if you can. It leads into the issue about contracts being sold on. We have had before us recently the issue of Capita buying up the court interpreters service, but I have anecdotal evidence—it is always difficult to prove and I have not had a chance to dig around—of contracts being bought and then sold on with the profit being taken by the original company. Is that something you will stop, or is it part of the Government's mission?

Vincent Godfrey: There are two parts to that. The first is that for the competition for the rehabilitation programme the country has been divided into 21 geographic areas, and we are in the pre-qualification phase. After a long period of market engagement, which we undertook jointly with the Cabinet Office, we have had 35 responses and there is a very good mix of different types of ownership structures in there. Some are mutuals, some are larger companies and some are large companies working in conjunction with voluntary and community-based organisations, SMEs and so on.

On the second part of the question, we are doing the very thing we talked about earlier and putting strict controls on change of ownership and the ability to sell on and manage these organisations, so that has the second part of the provision in there as well.

Q80 Meg Hillier: So is that saying they won't be able to, or that they will talk to you about it?

Vincent Godfrey: They have to discuss it with us and ultimately get agreement from us to be able to do that.

Q81 Meg Hillier: And do you look in open-book accounting at the profit?

Bill Crothers: Yes. We have a contract—one of the larger contracts—with a supplier that is selling a

substantial part of its business to another company and in selling it their contract with us is also being sold. We think the contract is an example of really bad commercial practice and has been for the past two years, so we are using our change-of-ownership clause to our advantage to negotiate better terms. We may let the contract be sold and, if it is, its terms will be changed, or we can use a sanction to say that the company cannot sell the contract and we will stop it as a material element of the sale of the business.

If we are commercially smart, that is the sort of thing we can get involved in. I take your point. Across the system—ATOS and this or that—we cannot get everywhere, but if it is a big thing we intervene with the complex transactions team, which is for big deals. It gets involved and acts as an adviser on that sort of thing. If it is perfect, the change of ownership will be to our advantage because we will either stop it or improve it in a way that suits us.

Q82 Meg Hillier: That sounds great for the big ones, but going back to probation—you could say the Work programme too—which has similar problems, you talked, Mr Godfrey, about working in conjunction with SMEs, the voluntary sector and so on. What I am finding with, for example, the Work programme—we picked up on this in Committee—is that many of my smaller suppliers find that if they agree to go with the prime, they are ripped off because the cut for the prime is big and the little bit that trickles down is not worth it. They cannot be sure of the work and they do not get a good deal, so in my area they often choose not to bother. Some have, and have found that they were ripped off. Ethically, the Government are trying to support small businesses and they are the ones that are losing out. How deep down can your team go, or is this a culture that must get right down to the lower level?

Bill Crothers: We should mention that it is essentially a whistleblower service. It is called “mystery shopper”. If someone is involved in procurement or a situation that they are unhappy with, they contact us. That is anonymous and the Cabinet Office then takes action and follows up. There have been something like 500 or 540 successful interventions.

Q83 Chair: Can you give us an example?

Stephen Kelly: With one SME, we did an investigation, changed the outcome, and they hired some extra people, because they planned their business on a contract with Government. There have been 540 interventions where—

Q84 Meg Hillier: Did they get more money?

Bill Crothers: They got the contract.

Stephen Kelly: They got the contract.

Q85 Meg Hillier: Directly with Government?

Stephen Kelly: No. Well, there are two things. One is that we are not there. Bill and I found an incident in the supply chain. There are a number of things. You know that we have done all the stuff on payment terms, better customer service and a better supply chain. The other thing is that one contract has a 33% margin for the prime contractor, taking a

subcontractor through. You and the guys last week could argue that there are lots of issues around taking risks and so on, but we react and ask questions when we see pass-through margins above 10%.

Q86 Meg Hillier: Good. I am glad. We will hopefully come back to this in future, because there is a really big issue there. Some of those small companies will never be able to take the risk, because the Government will always go with the big ones, and the big ones will always make that cushion part of their job.

I have one last point about when you set contracts. I asked all four witnesses last week whether they had ever been asked about the hourly wage for their lower-paid members of staff as part of the contract. They all said that they had never been asked. What do you say you do about that? If you are dealing with Serco, do you care about the wages of the poorest and the hourly rates?

Vincent Godfrey: Yes, on the contracts that we are letting at the moment—

Q87 Chair: Which ones?

Vincent Godfrey: We are looking at the facilities management contract on our headquarters buildings at the moment, for example. We are therefore in discussions with the bidders on that particular contract about the wages that they are paying and so on.

Q88 Meg Hillier: Will that be in the contract?

Vincent Godfrey: It is under discussion at the moment. Referring back to an earlier point, SMEs are obviously concerned about payment terms, and we use some very practical tools to deal with that. In a recent project at Cookham Wood prison, we used a project bank account, so we had clear transparency over when the suppliers were paid, and we were actually able to see the financial flows of money to the subcontractors. On the rehabilitation programme, we are looking to put in place an industry standard form of subcontract, so that when we award the private contracts, those that come into that supply chain are effectively afforded back-to-back terms and conditions. We are trying to ensure that fair terms and conditions flow down the supply chain, which is not uncommon in construction, where you have standard suites of contract, but that is something that we are putting together as part of this procurement.

Q89 Chair: It is good to hear that. I want to intervene to raise another point. You win your contract because your price is low. You start implementation, but you have to do various things because your price is low. You sometimes damage services, such as Serco in Cornwall, or you cut wages. Reporting on this last week, the *Financial Times* referred to an instance involving Serco and Lincolnshire police—I accept that this is Home Office—where they took people over on TUPE at £26,000, and then advertised for replacements at £7,000 less. They were paying them £17,000. The *Financial Times* said that that was the same as stacking shelves in Tesco. I do not know whether that is right, but that was the comment. You want efficiencies, but to take Meg's point, you do not

necessarily want to get them simply through cutting wages, do you?

Stephen Kelly: What we can do, Madam Chair, is everything that we are trying to do, but we can also remind the companies that we deal with of citizenship and responsibility. You have seen some of the letters that we have written to say, "This is part of our overall citizenship expectations." Within the certification, the high risk and other elements, we follow the policy and the process, but the message we give to our suppliers is equally important. There are 200,000 suppliers, but we make clear in the sessions that we have with the material ones, which probably make up some 50% of the £40 billion that central Government spend, our expectations and what we see as good citizenship. It is about not only doing what it says on the tin and delivering services and saving money for the taxpayer, but also responsibility.

Q90 Chair: So what would you do in this instance?

Stephen Kelly: In that specific instance, to be candid, we would probably call them in. There are a couple of things. If, like Meg, you have got SMEs' CEOs writing to you and there are any things that worry you, point them at a mystery shopper. If that does not resolve it, point them at us. Likewise, with those situations, you can point them at us. We will commit to you: we will look at it.

Q91 Nick Smith: I have questions for Mr Mosco and Mr Godfrey, but I want to pick up on Mr Kelly's point about the Crown being the better customer and, particularly, about controls, including senior management controls. There have been several high-profile failures by suppliers in recent months. I am trying to understand why you did not know what was going on. Mr Mosco, what went wrong with the Army recruitment contract with Capita?

Les Mosco: That is fundamentally down to IT problems. Our recruitment partnering project with Capita is quite a complex mix of things, but one of the dependencies that was in the work that Capita was doing was usage of, and access to, an MOD IT system, and there have been problems with that. That is the principal reason why there is a problem on that contract.

Q92 Nick Smith: Did you expect there to be IT problems with one system not being able to talk to another?

Les Mosco: No. It needed work to be done, but we should have expected it to have been okay.

Q93 Nick Smith: Why didn't the person responsible anticipate it, so that it did not occur?

Les Mosco: I think it has only recently become apparent. A lot of work is going into sorting out what that problem is, and working out the alternative way forward. That is subject to very active discussions as we speak.

Q94 Nick Smith: Given that this is a major plank of Government defence policy, I still do not understand why it is becoming apparent only now. Why is that?

25 November 2013 UK Government, Ministry of Defence and Department of Health

How far into the contract are you, and when did you find out that there was a problem?

Les Mosco: The initial operating capability, as we call it, was due earlier this year—I think it was March '13—so it is only fairly recently that this has become apparent as an issue. What we have been doing since that became apparent is, first, trying to work out what the IT issue is and to see how that can be fixed and, secondly, putting more people into the process to make up for this problem.

Q95 Chair: How many soldiers have you put into the process?

Les Mosco: We have reduced the number of soldiers involved in that project by less than we should. I do not have the exact numbers, but—

Q96 Chair: We were told last week that the whole purpose of the project was to get 1,000 soldiers out of front-line recruitment and that, because of the failure of the IT, you had put 1,000 back into doing that because the figures had gone down.

Les Mosco: I think that the original intent was that about 1,200—

Q97 Chair: I know what the intent was. When the IT failed, how many did you put back in?

Les Mosco: About 2,100 military staff used to help with recruitment, and that was going to be reduced by about 1,200. So far, 347 have been released.

Q98 Chair: So another way of looking at it is that you had to put 800 back.

Les Mosco: We are behind the curve in the reduction that we should have had.

Chair: Another way of looking at it.

Q99 Nick Smith: I still do not understand why no one at your level knew that this was a car crash waiting to take place.

Les Mosco: As I say, the initial operating capability was only intended in spring of this year, and when it became apparent that that was not so, a lot of work was put into it.

Q100 Nick Smith: Did you pilot it before you rolled it out?

Les Mosco: Could we, or did we?

Q101 Nick Smith: Did you?

Les Mosco: I am sorry, I do not know the answer to that. I can get back to you on that.

Q102 Chair: And what do 800 extra soldiers for that period cost the taxpayer? There is an MOD culture thing here. You knew that we were going to ask about this; we asked about it endlessly last week.

Les Mosco: I do not know the average cost of a soldier. That would all depend on rank, grade and so on.

Q103 Chair: Oh, God. Well, give me a vague figure. That was a non-answer. I want a better answer than that.

Les Mosco: I can get back to you on that. I do not know—

Q104 Chair: No, you knew that last week we asked questions about how many soldiers were supposed to be taken off recruitment and put on the front line. The argument was 900 to 1,000. There must be a cost. I cannot believe for the life of me that the MOD does not have an average cost.

Les Mosco: The MOD may. I am sorry, Madam Chairman, but I do not have it with me here today. I can get back to you on it.

Chair: I am pretty shocked at that. It was completely clear from last week's hearing—you have all had the advantage of our having had that hearing—that this would be raised today.

Q105 Nick Smith: Dreadful answer. What will you do to resolve the issue?

Les Mosco: The issue has been examined at very senior level—up to and including permanent secretary and the chief information officer.

Q106 Nick Smith: Have you been involved?

Les Mosco: Only very recently. The issue of what the cause of this is has been examined at very senior level.

Q107 Nick Smith: Hold on. You are the person responsible for this contract with Capita. Is it part of your job to have responsibility for this contract?

Les Mosco: I do not own every contract in the MOD. We place about 4,000 to 5,000 contracts per year. I do not know how many current contracts we have, but it is a large number.

Q108 Nick Smith: So it is not you. Is it in your Department?

Les Mosco: It is part of the MOD's contracting, obviously. It is owned by the Army recruitment team. It is they who take the lead on working out what the issues are. It has been escalated through the chief information officer and up to the permanent secretary. There was a major review only last week of what the fundamental options are.

In terms of fixing the IT problem, the basic choices are to try to continue with the original proposal—option 1—which was that Capita's system would integrate with the MOD system. Option 2 was to move away from that and have Capita responsible for the whole end-to-end process. Those were the two fundamental choices that are currently being decided between.

Q109 Nick Smith: Do you think that those two choices are sufficient to resolve the problem, as you see it at the moment?

Les Mosco: Yes, I do.

Q110 Nick Smith: Which would you recommend?

Les Mosco: If you are forcing me to give you an answer on that, I would put the end-to-end process with one company. That would be my choice.

Q111 Chair: Perhaps you can let us have a note on the additional cost incurred. This raises an interesting

issue about who picks up the tab. This is an example of a contract that has not delivered to specification. There is an extra cost on the MOD, whether it is 800 or 900 soldiers. The MOD picks up the tab at the moment. We could say the same about the MOJ when the interpreters' contract went wrong. The MOJ was not even able to tell us how much the extra cost of that was. You could go round others. Who should pick up the tab? Why can't we get that bit of it right?

Bill Crothers: A good contract would have something called a consequential cost or a consequential loss clause. If it is that clear, you should have conversations and suppliers should pay, but it is rarely that clear. If Richard Bacon was here, I am sure that he would talk about us being a better customer and needing to be more disciplined, because you get into conversations with suppliers, and no doubt they will say that it is our fault, and we will say that it is their fault. We need contract discipline, good contract management—we are talking about a clause that is probably there already—and us to enact our rights and just do it with simple discipline. It sounds simple, but it is not that simple, and that is what we should do.

Amyas Morse: I think you are being given a fairly clear answer, if I may say so, Chair, in that there was a key dependency that the system supplied by the MOD would work in a certain way. You have been frank in saying that it has not worked in that way. I do not see how it is going to cost the supplier.

Les Mosco: I agree with what Bill says about consequential loss clauses. If I was sat here saying that I know that this was entirely Capita's fault, I would be going after them. Right now, it is not clear that it is entirely their fault. I do not think that that is a case that I could assert, so this is not a contract claim that I can go for. In other cases, we would.

Q112 Chair: If you had a tougher contract, it might have been clearer.

Les Mosco: No, it is not a question of a tougher contract—this contract will have those clauses in—it is what actually went wrong here. Was it Capita's fault or a mutual dependency thing? I don't think this is a case where it is Capita's fault.

Q113 Nick Smith: This is a question to Mr Godfrey. Last week we had G4S in front of us. As part of their press release the day before, they said they thought themselves to be contractually entitled to bill for monitoring services when equipment had not been fitted or after it had been removed. They then proceeded to apologise for that view and the profit they had made. Why didn't your Department spot that?

Vincent Godfrey: The issues around it being spotted, the identification of the issues and so on are a matter of a criminal investigation at the moment, so I would be very reluctant—

Q114 Chair: Nobody has been charged, Mr Godfrey. I think you are free to answer those questions.

Vincent Godfrey: There are two points. First, I and the Department would firmly contest that they are contractually entitled to charge those amounts. So for example, you talked about instances where subjects

had not been tagged, and so on and so forth. We are very clear that they are not contractually entitled to do so and we are obviously fully pursuing the recovery of the moneys for that. That is an ongoing process. The second issue—

Q115 Nick Smith: Can I just stop you there? I am glad to hear that you are contesting the contractor being paid for something they did not do. That is really good. Okay, but why didn't you spot that at the time?

Vincent Godfrey: As I say, I need to be careful here because the issues around it are the matter of a criminal investigation—

Q116 Chair: Nobody has been charged, Mr Godfrey. All you are being asked is, why didn't you spot it?

Vincent Godfrey: It is the matter of an investigation—

Q117 Chair: Why didn't you spot it?

Vincent Godfrey: I am going to repeat the answer again.

Q118 Chair: No, I think you are using that as an excuse. There is nothing in the question, "Why didn't you spot it?" that would impact on the case.

Vincent Godfrey: The Ministry of Justice did spot the issue, albeit very late in the life of the contract, so it was actually the Ministry of Justice that spotted the billing issues initially—

Chair: No, you had a whistleblower. It was a whistleblower who came forward.

Q119 Austin Mitchell: How did you first get to hear there was a problem?

Vincent Godfrey: The over-billing issues that were identified were identified by the Department in February, and they are separate—

Q120 Chair: By a whistleblower, Mr Godfrey.

Vincent Godfrey: No, we identified it as part of the procurement process. The subsequent note from the National Audit Office on that would confirm that.

Q121 Chair: I thought it was by a whistleblower.

Gabrielle Cohen: It was both.

Stephen Kelly: It was both. It was in the spring of this year and the MOJ enacted us. The process since then is probably a good example.

Q122 Nick Smith: When did you identify it?

Vincent Godfrey: The Ministry of Justice first identified it as part of the procurement process in February this year—that was my team. There is a story to it in terms of following up further investigations and so on that subsequently led to the commissioning of the PWC audit at the back end of April, early May, so there were various follow-ups and so on with G4S as part of that process that subsequently led to the commissioning of the PWC audit.

Q123 Nick Smith: To be clear about the timing, you said you found out about it this year. How long had they been billing you for work they had not done?

25 November 2013 UK Government, Ministry of Defence and Department of Health

Vincent Godfrey: Since 2005.

Q124 Nick Smith: So what have you done about it since?

Vincent Godfrey: Since then we have replaced the contract management team. We have an entirely new contract management team. It is a team which, as Stephen was describing earlier, has mixed skill sets. We have people with audit experience and people with operational contract management experience, and we have analysts working on it as well, so it is a different type of team. It is a team that is co-located with the contractors, so the people who are working for me are based in the G4S and Serco processing centres at Manchester and Norwich respectively. They have day-to-day oversight of what is going on in those processing centres and so on, and they are managing the contracts on that basis.

Q125 Nick Smith: You have changed the team and the structures; well, that sounds good. Was it the same team who was managing it from 2005 to 2013?

Vincent Godfrey: There were a number of personnel changes. The contract since its inception in 2005 was managed by—

Q126 Nick Smith: Particularly the billing.

Vincent Godfrey: I would need to check whether the people who were responsible for the billing changed. As I say, there were a number of personnel changes in the management of the contract between 2005 and today, and I have only had responsibility for it since April of this year.

Q127 Nick Smith: Okay, one final question—has anybody been sacked over this?

Vincent Godfrey: There is an ongoing disciplinary investigation, so I couldn't comment as to where that is—

Q128 Nick Smith: It is still ongoing?

Vincent Godfrey: As far as I'm aware, it hasn't concluded.

Q129 Chair: How long has it been ongoing?

Vincent Godfrey: I am not sure how long it's been ongoing; I would need to check.

Q130 Austin Mitchell: Are we to see the deprival of Serco from three prison contracts in Yorkshire as a form of punishment for this?

Vincent Godfrey: No. The decision was made for operational reasons.

Q131 Austin Mitchell: Should it not be connected?

Vincent Godfrey: Well, it wasn't connected; it was made, as I say, for operational reasons.

Stephen Kelly: Separately, Mr Smith, I will say a couple of things. I have come in in the past, and there are a couple of things to say. How do we stop coming back to you and having these sorts of conversations, and make sure we are doing a good job for the taxpayer and delivering good services to citizens? I would observe that either commercial operational skills have not been valued by the system as much as

they should have been or we have been through a process of deskilling these critical skills, particularly in contract management. I think Bill's comments earlier around having very senior ownership of these are important—contract management: really raising the game, rather than just focusing on procurement. I think also when you look at throwing, effectively, a contract over the fence from procurement to contract management, we could improve there, and also the whole fundamental essence about how a lot of these conversations will come out on change control notice and the ownership of those at a much more senior level.

I think on our side of the table there are definitely some major lessons learned. Bill has led this cross-government review, which is in the process of concluding in the next few weeks. You might like to just—hopefully—give some reassurance that the plan will be not to come back and have these sort of contract car-crash conversations, because—

Q132 Chair: Mr Kelly, you are very good at being candid. I will tell you that my worry with MOJ is that it is going really fast on contracting out—there is a huge amount of business going out on contract. Is it your view that it is going too fast for the capability in the Department?

Stephen Kelly: There are a number of things. On the MOJ specifically, there are some things, particularly in the rehab area. In the light of what has happened during the summer, the NAO has overseen the work that Bill has led on the cross-government review. That is feeding its way into the current discussions on Rehab. Candidly, it is probably too early to say, but sitting here today, I think the lessons learned are being applied.

Q133 Chair: So are they going too fast just to be able to absorb it? I do not feel massive confidence. Having got some rotten contracts to date, we now go out again with probably one of the biggest outsourcing bits that we have got across Government, but is the capability really there? Would you feel confident that you are not going to be having this conversation with us in a couple of years' time?

Stephen Kelly: On some of these elements specifically, obviously we will have an oversight through the Major Projects Authority—I am not copping out of the question, but probably what you want to do is get the accounting officer for the Department to answer that specifically. I will assure you that effectively the Cabinet Office and the MPA and the core functions of the Efficiency and Reform Group is supporting some of the lessons learned coming out of these situations that we found and making sure we do not revisit the same mistakes we made in the past.

Q134 Nick Smith: Can we challenge you on that, Mr Kelly? You talked earlier in terms of the capability to bring in some poachers to be gamekeepers and a new cadre of people to help you with this work. Then we talked about these two instances of contract car crashes. Then, as part of his evidence in his contribution, Mr Mosco says, "Not me, guv. There's

five thousand MOD contracts out there. I can't be expected to have oversight of this little thing going on over here with recruitment and Capita." Like Miss Hodge, I am just afraid that the overall capacity is not there to stop this thing occurring again and again.

Bill Crothers: I would not disagree with you. When we do business there are three stages we go through: we think about what we are going to buy, we buy it and then we manage it, post contract. It is the case that most commercial officers spend most of their time in the buying, not in the managing of the contract or in thinking about what we are going to buy. If you break it into smaller contracts, it is exactly what Vince described with the new tagging.

As a general phrase, we spend our time in exactly the wrong place. The relative value is before the procurement starts and after the contract is signed, and most commercial officers spend all their time in the middle. Just to say to you, "It won't happen again," is too trite. For example, the management of this contract did not run up to the commercial director; it ran up somewhere else—it is probably a question about health assessments and DWP. They probably did not run up to the commercial director, so you have contract management that is not performed by a professional group. I am not criticising the people and their competence; it is just that they are not necessarily professionals doing the job. They should be, and they should run up to the commercial director, and there should be more of a visible line up to my function. Then you stand a better chance of hitting it. We should have essentially a checklist. The NAO produced a checklist in 2008. We had to dig it out; most people did not know about it. It is simple: it is just contract management 101. We should be following the basics—nothing complicated, just the basics—so we will try.

Chair: Chris is waiting. Amyas just wants to come in quickly.

Amyas Morse: I would like to come in quickly with one thing. I am very supportive of what you are saying, Bill, but I am a little bit nervous about the scale of resource we are talking about. Not only have you mentioned 400-odd people but I guess that you would need that to be complemented by maybe two or three times that many out in the Departments to have a chance—not just commercial officers but people who are going to do cost-accounting and things of that sort—to do anything like what you talked about.

That is a lot of money. Have you got any commitment on budget? Do you know that you are going to be able to get that money? I do not see how it is going to happen otherwise. I am very supportive but I would like to understand how you think you are going to get the resource.

Bill Crothers: There are a lot of people who do it today but they are not necessarily the right people or skilled or trained in the right way, or they are not reporting in the right way. I am not sure it is all new. There may be some new, and we have some provision centrally, but there are people there today who are not the right people or under the right structure.

Amyas Morse: But in austerity, do you think you can get those Departments committing the resource to do

it? I know they should but I am asking if you think you can get it.

Bill Crothers: When you look at the effort that Vince has applied, and we have been right there with him, in tagging with Serco and G4S it pays for itself. The economic argument of having people to manage contracts is easy. I take your point but it is self-evident that you should be managing hundreds of millions of pounds per annum with a few million pounds of people. It is self-evident.

Les Mosco: I am not sure how much comfort it will give you, Mr Smith, but prior to any of this, prior to Bill raising the contract management issue, prior to the Capita contract, in the MOD we recognised that we were not doing enough contract management, and have an initiative running to try to correct that. There are issues, as Amyas has said, to do with resourcing. I completely agree with Bill that it more than pays for itself. We expect our initiative to more than pay for itself.

Nevertheless, there are issues with overall headcounts that are capped, so you end up doing a prioritisation and trade-off between doing one set of work and another. We certainly recognised that we needed to put a lot more effort into contract management. Again, I agree with Bill and Stephen. The traditional philosophy is that the job is done when you have signed and placed the contract. That is merely an interesting point along the journey, because nothing has happened yet. Nothing has been delivered at the point you have signed the contract. Working through the delivery of the contracts and the contract management is a really important thing. We recognised that probably about eight or nine months ago and said, "You know what? We are just not doing enough." We had people doing it, but we realised that we needed to focus on it a lot more. I accept the criticism that we have not been doing enough of it, but we are at least on the case of trying to correct that.

Q135 Chris Heaton-Harris: I am going to drag us back to small businesses, if I may. It was a good intervention from Nick, and this is slightly out of order, so I apologise for coming back to it. You say that we do not have the capacity to manage some of the contracts now. It is scary to think that pre-contracting out, we were not just trying to manage them but we were trying to run them as well. I am quite happy with the direction of travel, but I would like to think that lots of small businesses can get involved.

Everyone has now got examples in their constituencies, and mystery shopper pointed a number of people down its direction. I have got a small business called Map Sight that has been told by the Home Office—the College of Policing, in this case—and others that because the licence is only for £5,000 a year for what it wants to do, it is in this kind of lost zone in procurement terms. It is way too small for people to get too excited about, but it is quite a useful tool for policing. It looks as though it is going to have to come out of petty cash somewhere in the police system rather than be allowed in. They also struggle because they are allowed to bid for this particular thing that they do but because they are a new small

25 November 2013 UK Government, Ministry of Defence and Department of Health

business, one of the criteria used is: can you produce three years of accounts? Not many small businesses can produce three years of accounts, and I would like to think we are looking at that particular area.

The other one was in transport. It was a Crossrail project, where the whole thing was contracted to one contractor, which then subcontracted all the way through the system. I just wonder how you maintain control of a contract through the myriad of subcontracting. In the end, this company, which is called Hi-Force, was not only the lowest bidder but the most domestic bidder for this particular piece of work, but they did not get it. They cannot find out why. They have asked the subcontractee above them why, but they cannot get any feedback. That is frustrating, because they cannot learn to bid better next time. I am hoping that you will be able to give us some comfort on sorting that out as well.

Bill Crothers: Three years' accounts—I thought that we had got rid of that.

Vincent Godfrey: We have.

Bill Crothers: Madam Chairman also said that Buddi or someone had to deal with thousands of pages of tender documentation, and we have got rid of that as well. The truth is that there is a lag between the policy intent—the guidelines, or whatever—and the habits. Old habits die hard, I guess. You will not get a young, innovative technology provider getting business with Government if they need to show a track record of three years' accounts, so we removed that. It is back to mystery shopper. We just have to keep saying it, and saying it loud. If people see tender documentation that is excessive, bureaucratic and thousands of pages, they should write to us—mystery shopper, Stephen, me or Francis Maude. Just write, and we will then deal with it when we catch it, and it amplifies through the system. That is the general point to your answer. On the too small, I find it hard to believe. I worked with the police for quite a while, and it is a fragmented market. It is difficult to find the right person, but if something is small and it is a great product, they should be snapped up. Again, I know it is not the right answer in all cases, but mystery shopper does help, or you find that small businesses that write to the permanent secretary often get a receptive ear, and they get dealt with. Mark Sedwill, I am sure, would deal with it.

The third point—too difficult, because it is a complex situation. If you are a subcontractor bidding to a tier 2, which in turn is bidding to a prime, it is complicated. We cannot help all businesses win business. If they think it is unfair, they should write to us and we will do what we can. We are just listening, and we are open to hearing these problems and dealing with them.

Stephen Kelly: Just one hint of optimism—we have not had too much of that—in terms of Bill's point. The procurement stuff for SMEs used to be about 6,000 pages and it was cut to 50, which is still too much, so we are on that path. The other thing is that the digital services framework was announced, I think, 10 days ago. There are 184⁴ companies on it, 840%⁵ of them SMEs. The good news is that 38%

are new companies that have never worked with Government before. There will still be regression to the past, and I hope we have some safety valves, such as mystery shoppers and ourselves, to intervene, but we are moving and pulling the juggernaut in the direction of supporting SMEs.

Q136 Austin Mitchell: It is worrying. If we are going to put out more contracts for Government services in this way, we need more effective supervision of the contracts. What is worrying is that the aberrations, such as G4S and tagging and the after-hours contract in Cornwall, come to light only through whistleblowers. I shall ask Richard Douglas first of all, what has happened as a consequence of the discovery that services have not been properly provided in Cornwall? We do not know whether any of the other companies providing after-hours doctor services are just dumping on the emergency services and drawing the money none the less. How do you know it is not going on elsewhere?

Richard Douglas: We are very clear that the lessons learned from the out-of-hours work in Cornwall have been disseminated through NHS England. Through its responsibility for primary care commissioning, all those lessons from Cornwall have been taken into that. The basic things are the same as those that Bill talked about. There are two elements: the procurement bid and the contract management. The procurement bid is about the level that people are bidding at and the contract management is about what they are doing in terms of what they promise. That is built into the work NHS England is doing.

Q137 Austin Mitchell: Okay. Let me ask Mr Crothers. I would think that it is difficult for smaller Departments particularly to manage the contracts effectively and to take effective control. Do we not need a centralised management review or centralised management structure to look at the contracts?

Bill Crothers: Yes. I think it is a balance. It makes sense for the centre to do that for those goods and services that we buy that are common or where the Departments are too small. For example, it does not make sense for the centre to manage the contract for the procurement of tanks or something ludicrous. In the centre, we have formed exactly that: a Crown commercial service to provide a commercial service—procurement and contract management—for either smaller Departments, those who do not spend very much, or for those common goods and services of the larger Departments.

I just want to say one thing on something we are doing. Besides the prescription—the technology, the process and changing things—one of the key ingredients is not competence, but confidence, and having commercial officers who are sufficiently experienced and confident to speak up. There has been an asymmetry between the suppliers and the officials. The suppliers sell deals, run deals and are earning big salaries. They have done it multiple times. Sometimes, they are up against officials who have none of those characteristics and, importantly, do not have the confidence to speak up and say, "That is wrong. You will not do that deal." or "That element is wrong." If

⁴ Witnesses note: 1834

⁵ Witness note: 8%

we can get our commercial officers to be more confident, we will go a long way. The competence will follow, but the confidence is absolutely key.

To give a quick example, we have a supplier who was charging us a finance charge of 15% for invoices that were paid in more than 30 days. When I raised that with the lead person in the supplier, they were quite brusque and said, "That's what we charge." When I raised it with the global chief executive, he said, "That's what the contract says." Speaking up with these companies requires confidence. If you are a reasonably junior official, you just get washed away. I am not a shrinking violet, but with these guys it was almost, "How dare you raise it? It's contracted." My answer was, "It's unfair. It's abusive. You should not do it." Confidence goes a long way.

Q138 Chair: What is the end of that story, Mr Crothers?

Bill Crothers: We got the money back, and I believe they are not charging it any more. They are doing the right thing.

Q139 Austin Mitchell: I had somebody doing the asphalt on my drive once. I have one more question before Mr Crothers comes in. It struck me that a lot of the problems have developed because we have these huge organisations that have grown very rapidly, like Topsy. They do not have effective control structures over the parts that are doing the job or over the people they are subcontracting to. A lot of it seems to come from bad internal auditing and bad control structures in these companies. As the NAO says, it is difficult to provide for that in contract terms. How do you do it? How do you develop the confidence to see what is going on and understand the organisation?

Stephen Kelly: On our side of the fence, Bill talked about confidence. We talked about capability. The other "C" is the culture where commercial and operational skills are valued within the system, and we have got a whole remit around the Commissioning Academy. We can come back and talk to you about 1,800 people put through lean procurement, and better contract management skills through the Commissioning Academy. But I think that the point you are making is on the other side of the table, particularly with the big suppliers, and particularly those that have acquired a number of companies. How can we be assured that they have the control environment?

I have not been⁶ the CEO of a NASDAQ or a FTSE company. I have done corporate renewal. The work that we did with the National Audit Office in the summer has given guidance around what good corporate renewal—a good control environment—looks like from a company's point of view, and it highlights some of the elements you are talking about. We have published that now, and we would encourage companies to raise their game in terms of the appropriate control environment to give us the assurance as a customer.

Q140 Chair: Mr Kelly, I will comment on that, and then we have two or three questions, and then we can

close it. I am pleased to hear that, but I picked out Serco from one of my folders last week. There were four current contracts where the control environment led to a not very effective service. I think that what they do is come in low on price, get the contract and then, to try and get the profit, they damage the service rather than get efficiency savings.

Perhaps this is one for Mr Douglas. They are not all in there. We have the Cornwall contract we have talked about. There is a community health care contract in Suffolk that the NAO will report to us about. There is the prisoner transport in London and East Anglia where there were problems. Serco staff manipulated the statistics to improve performance data. That is very much what they were doing in Cornwall. And there is the pathology labs contract where they had 400 clinical incidents in 2011, including losing and mislabelling samples. That is just a couple of hours of my looking at Serco. Those sorts of issues, all of which are important, become so systemic that you say, "Hang on, we've had enough of these big guys." It's back to the "too big to fail".

Stephen Kelly: From the company's point of view, we are very respectful; we have got a duty of care to the customer. If I were on the company's side of the table, a lot of it is around culture, the code of ethics, the tone at the top and all those sorts of things, the control environment and then the appropriate governance and the structure, empowerment of the board, and the audit committee: all those things we know and love. However, you have seen a clear example of a specific situation during the course of the last few months where we have become aware, and that has led to the cross-Government review. Out of that, over the next few weeks, recommendations will come. Bill, do you want to cover anything specifically to—

Q141 Chair: I know you are doing all this good work, but this feels pretty systemic to me.

Bill Crothers: Or "too big to fail", is that your point?

Q142 Chair: It is partly too big to fail. It was an argument we had with DWP when we were looking at one or two of the private providers on the Work programme. Where do you define systemic and then cut the umbilical cord?

Bill Crothers: It is a complex situation. Three years ago, we would not even have known the scale of the relationship. In fact, with some suppliers, three years ago, we asked the size of the business, and the Departments told us that in one company it was £600 million, while the company told us that it was £800 million a year. The right answer turned out to be £1.5 billion, and it was because we asked the question slightly differently. Honestly, I do not think the suppliers knew the scale of their business with us, because they did not add it up that way. They treated each Department as a different client. I know an ex-chief executive of one of these companies—I know him well—and he did not do that. He just did not see the world that way. His business was DWP, MOD and he did not add it up.

So we did not even know the scale of the relationship, and then we did not have a single point person—the Crown representative—to know all the business and

⁶ Witness note: I have been ...

25 November 2013 UK Government, Ministry of Defence and Department of Health

all the issues, and to be able to deal with it. Then we did not have a poor performance policy and a high-risk policy for suppliers who were systemically underperforming. It is not a panacea, but those are devices that we have now that need to get bedded in and be used, and for there to be consequences. It is not simple. It means that if somebody is systemically, materially underperforming, we look at them and we consider them as a high-risk supplier. If they are a high-risk supplier, there are consequences, and those are that we want them to get a recovery plan. So, it is not a simple answer—there is no silver bullet—but I honestly think that we have the devices in place to try and deal with what you are describing. We just need the attitude and the judgment to do it.

Richard Douglas: Should I talk about the three health examples that you mentioned?

Q143 Chair: Were there three health?

Richard Douglas: You mentioned three, yes. Clearly, the Cornwall case is a proven one that we have been through. With Suffolk, the NAO is doing its work at the moment. I am not getting serious issues reported back to me on Suffolk. Pathology-wise, there is the joint venture with Guy's and St. Thomas' hospital, so I assume it is that one. Again, I have not had major issues coming through on that.

There are two things to say. First, if you take the thing about being too big to fail, none of these are too big to fail from an NHS perspective. If you look across the NHS business that these organisations are doing, it is perfectly substitutable. It is not on a scale that gives the problem you are suggesting. The other thing to mention is that with the key supplier management and thinking of the Government working as one, one of the shifts that we have made in the past six months—Bill and I working together—is to bring the NHS into that. The whole key supplier management is focused very much on looking at central Government Departments. What we are keen to do is bring that right into the NHS as well, so that management relationship also looks at the NHS—not just the big suppliers across Government, but we replicate the approach that Bill has adopted for NHS-specific suppliers as well.

Q144 Chair: Okay, well we will watch this space. The only other thing is a competition question. If we look at the first report, which we did last week, you will see, for example, that 46% of Atos's revenue comes from contract extensions, and that 29% of Serco's comes from a single tender. You will also see, back on contracts, that one of Serco's is 40 years, one of G4S's is 30 years, and Atos's and Capita's longest ones are 15 years. How can we protect the taxpayers' interests when the contracts are made in that way?

Stephen Kelly: Obviously, of the £10 billion overall, probably about half⁷ the savings have come through

areas controls operate, and a lot of the controls are around contract extension. Fundamentally, we know that when you re-compete, you get much better value for money. That is well proven.

Q145 Chair: So what are you doing to change that?

Stephen Kelly: We need to look at it segment by segment. Bill has got some work in flight looking at the next few years.

Bill Crothers: Every contractual commitment over £5 million—that is not per annum; it is £5 million, whether it is a change request or an extension—for the strategic suppliers needs the MCO's approval. They need Francis Maude's approval, and they are recommended either by me or by one of the Crown representatives. We have seen quite a drop in them. Occasionally, Departments do not leave enough time to run competition. The NS&I contract, for example, has now been re-competed. I am not sure when the extension happened, but the competition was run. As it happened, Atos won the re-competition, which might be another story, because the NAO makes a point about incumbents often winning the contract. I don't have statistics, but we now have a control that prohibits, stops or discourages extensions and change requests. You have given examples. I could give you many more examples of contract growth by two, three or four times, where contracts have gone from £250 million to £1 billion. Competition is good and we should not be extending, because the increment between the award and the out-turn is a gift without good commercial pressure. So we are working on it. The one you highlight has been addressed; I don't know about the Serco one.

On the duration of contracts, personally I like contracts to be short—three, four, five or maybe seven years. In some cases, there are reasons. The Serco one, for example, is a very, very material, large, complex, special-purpose vehicle looking after a facility. There might be a reason for that. But typically we should have contracts that are shorter, or you have easy ways to get out of contracts. Often, it can become a loveless marriage, where you're tied to it and the penalty for getting out is too expensive. Again, we are looking at that. It doesn't matter if a contract is for 10 years as long as you can walk away after two. The contract length becomes the wrong battle if you can get away.

Stephen Kelly: Going back to where we started, on things such as Contracts Finder publishing all the pipelines, we published data on £70 billion of contracts about 18 months ago; now it's £169 billion. Bill's team are working with the Departments on the forward planning for when those contracts come up. Could we do better? Absolutely, but now we are getting the data to see when contracts come up—2015, 2016, 2017—and we can proactively manage with the Department the competition for those contracts.

Chair: Good. Thank you very much indeed.

⁷ Witness note: 60% of

Written evidence from Serco

Further to the hearing of 20 November we offered to respond with further information in writing. Our response, along with additional information and clarification in a number of areas, is supplied below.

Q47—50—*Serco Geografix Ltd*

Having read the exchange in the transcript and gained more information than I had at the time of the hearing, I wish to clarify my comments regarding transparency with the Ministry of Justice (MoJ) on the interaction between Serco and Serco Geografix under the Electronic Monitoring contract. The transparency to which I referred related to the basis of the ownership relationship between Serco and Serco Geografix Ltd. rather than the transparency of Serco's financial arrangements with Geografix, into which I have now initiated further investigation, about which I am informing both the MoJ and the relevant authorities

Q74—*Bid costs as percentage of contract value*

The average bid cost incurred by Serco as a percentage of revenue falls within the same 1% to 2% range cited by other witnesses in respect of their companies in the hearing.

Q138—*Risk transfer (Work Programme)*

Further to my answer to this question, I am able to supply some additional information. First of all, under all circumstances we retain the reputational risk of delivery—if our sub-contractors do not deliver it would be Serco's responsibility to make good on our promises. Secondly, those organisations with which we sub-contract do bear a proportionate element of financial risk based upon their delivery against their contract with us. Nonetheless, our pricing mechanism within a Payment-by-Results contract, such as the Work Programme, is structured to assist providers (particularly the SMEs and VCS organisations within the supply chain) with cashflow and management of financial risk. The assistance is in many cases significant: for example, attachment fees are paid to the supply chain when customers start the Work Programme for five years. Serco on the other hand only receives attachment fees from the Department for Work and Pensions (DWP) for the first three years. Fees are also paid to the providers when customers start work and also when they remain in work for 13 weeks, although Serco receives no revenue from the DWP for these outcomes.

We believe that this provides the information requested in addition to providing further clarification in a number of areas where we feel this would be helpful. However, please let us know whether the Committee have any further requests for information following this letter and we will endeavour to provide it.

Alastair Lyons CBE
Chairman

26 November 2013

Written evidence from Capita

RECRUITING PARTNERING PROJECT—FURTHER INFORMATION

1. Either directly or via the NAO, Capita is entirely willing to provide the PAC with a more detailed briefing on the procurement, the contract and subsequent developments that have impacted on the recruiting operation. Capita will also be pleased to host a PAC visit to our recruiting operation in Upavon Wilts. Out of fairness and respect to our MOD client and the contract management team, we ask that any such request for a further briefing or a visit be directed and coordinated through their offices.

2. With respect to specific questions posed and answers given by Mr Pindar, Capita and he wish to inform the committee of the following points, be they on items requested by Committee or simply of clarification:

Q172—Regarding numbers of Army personnel allocated to the RPP operation, Capita's contracted solution foresaw 758 personnel being deployed directly into the Capita operation once the service was fully operational capable Approx 75–80 of these posts currently remain unfilled. This was a planned reduction from the pre-contract service personnel headcount of 2,100 approx. The service is not yet fully operational capable owing to the IT difficulties mentioned in the hearing. While the planned headcount reduction has occurred as planned, the impact of the IT delay led the Army to allocate 100 Army personnel to temporarily support the RPP operation.

Q175—Given media reporting of Mr Pindar's comments, he would like to clarify his answer by expanding as follows "Secondly, and I am not being flippant saying this, we also have a disadvantage that we have no wars on *of the sort that can actually have a positive impact on recruitment*"

Q179 and Q180—Below are the latest statistics on application and load to training numbers.

Unique visits to Army Jobs website currently run at 450k-500k/month, translating into the following registrations and applications. Largest drop outs in the pipeline are due to ineligibility and medical reasons and these account for 65%-75%.

This table shows the progression over time of applications submitted since registration. My account registrations are reported at unique customer level***																
		Applied →							Expected to		Actual		Expected			
Month	My Account Reg****	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total applied 13/14	%	Total yet to apply	Expected to still apply	Expected total	%
Apr	16,907	4,683	1,147	416	341	246	195	166	169	169	7,194	43%	9,713	507	7,708	46%
May	15,755		4,189	956	480	276	192	175	158	158	6,268	40%	9487	945	6,943	46%
Jun	15,179			3,934	1,052	331	230	170	152	152	5,717	38%	9462	1,265	5,773	46%
Jul	14,583				3,975	822	350	245	146	146	5,392	37%	9191	1,316	5,673	46%
Aug	13,860					3,633	707	340	277	139	4,691	34%	9169	1,685	5,504	46%
Sept	13,403						3,238	807	335	268	4,045	30%	9358	2,120	6,165	46%
Oct	16,032							3,663	962	321	3,663	23%	12,369	3,712	7,375	46%
Pre Apr/Dups		2650	1705	1151	1056	877	678	581			8,698					
Total	105719	7333	7041	6457	6904	6196	5590	6147			45,668	43%	68,749	11,550	48,520	46%

Load to Training Requirement and Actual performance

Soldier Demand Plan																
DEMAND	Apr-13	May-13	Jun-13	Jul-13	Aug-13	Sep-13	Oct-13	Nov-13	Dec-13	Jan-14	Feb-14	Mar-14	SEP-MAR TOTAL	Full Year TOTAL		
Regular Soldier	1,066	694	640	720	312	1,749	841	614	40	986	912	1,141	6,283	9,715		
TA Soldier	150	314	600	432	550	650	576	622	84	850	662	510	3,954	6,000		
Regular & TA Soldier	1,216	1,008	1,240	1,152	862	2,399	1,417	1,236	124	1,836	1,574	1,651	10,237	15,715		
Actually loaded to training																
Reg Slidr	762	398	470	491	244	1,482	468	285	21	175	37	26	2,494	4,859	50%	
TA Slidr	264	89	242	87	102	154	33	22	0	5	1	0	215	999	17%	
Total	1,026	487	712	578	346	1,636	501	307	21	180	38	26	2,709	5,858	37%	
Forecast																
Reg Slidr	762	398	470	491	244	1,482	715	553	34	947	876	1,095		8,066	83%	% of RAP
TA Slidr	264	89	242	87	102	160	156	100	100	713	925	1,188		4,126	69%	
Total	1,026	487	712	578	346	1,642	871	653	134	1,660	1,801	2,283	0	12,192	78%	
Dependent on achievement of application targets set in Op FORTIFY FragO 004.																
Officer Demand Plan (incl PQ)																
Reg Offr	0	196	0	0	0	192	48	0	0	240	0	0		676		
TA Offr														351		
Total	0	196	0	0	0	192	48	0	0	240	0	0	0	1,027		
Officer forecast (incl PQ)																
Reg Offr	0	194	0	0	0	192	48	0	0	240	0	0		674	100%	
TA Offr	0	0	36	31	12	54	127	35	0	0	55	0		350	100%	
Total	0	194	36	31	12	246	175	35	0	240	55	0	0	1,024	100%	

NB: In any recruiting year the Load to Training volume comprises candidates who applied:

1. In the same Recruiting Year 17%
2. In the Recruiting Year-1 58%
3. In the Recruiting Year-2 15%
4. Older 10%

Q181—The competitive procurement process lasted two and half years culminating preferred supplier in February 2012 and contract start in March 2012. During the procurement process Capita and the Authority reviewed every aspect of the proposed solution using a number of serving Military subject matter experts, the solution was modified as a result of this input. The identified savings were in the order of £300 million. Capita then deployed its management and operational resources in readiness to take responsibility for the service on the 26th March 2013, which it did on the planned date. However, this was not at the planned level of full operational capability owing to IT difficulties. Consequently a re-engineered solution was deployed at short notice and this is a fully collaborative arrangement between Capita and the Army.

Q182—Please see clarification above to Q172

Q184 and 185—Capita has received no additional revenue as result of the MOD decision to reduce regulars and increase Reservists.

Q188—Capita has not incurred any financial penalties to date.

Q189—Please see clarification above to Q181.

28 November 2013

Written evidence from Atos

ATOS—DISABILITY LIVING ALLOWANCE AND ATTENDANCE ALLOWANCE

This note provides an update on the Atos Healthcare contract with the Department for Work and Pensions (DWP), specifically in relation to Disability Living Allowance (DLA) and Attendance Allowance (AA) which was covered in an article in the Daily Mirror on the 20th November.

The area of the contract in question relates solely to the provision of clinical advice to DWP Decision Makers for working age recipients of Disability Living Allowance and Attendance Allowance.

The contract came to a natural end in March 2013. Since then Atos Healthcare has had its contract extended on four occasions: two three month extensions and two one month extensions, which bring us to the end of November.

The payment terms and conditions of these extensions have remained the same as the initial contract. Atos Healthcare is not being paid more for this work than previously.

The Department for Work and Pensions is reconsidering the scope of this contract and has been discussing this with us. We have not yet had final confirmation of the change in scope but we have incorporated changes to the volumes and performance regime in the most recent extensions. We will adapt our service to the Department's final requirements when they are confirmed.

As stated during the Public Accounts Committee Hearing on November 20th 2013, we would not withdraw from a frontline Government service without the agreement of the Department.

29 November 2013

Supplementary written evidence from Atos

ATOS—CORPORATION TAX

1. GENERAL

During the Public Accounts Committee meeting on 20 November 2013, Ursula Morgenstern was asked for a note around the reasons why Atos' UK companies were not required to pay UK corporation tax for the year ended 31 December 2012. This note explains the primary reasons why this was the case.

Atos complies with both the spirit and letter of the tax law. For 2012, the Atos UK companies recorded a profit before tax (PBT) of around £46 million. However due to a number of timing differences between the calculation of accounting profit and the calculation of taxable profit (on which corporation tax is paid), the taxable profits were reduced to nil.

The three primary timing differences were as follows, and are further explained below:

- Pension contributions into defined benefit pension schemes.
- Capital allowances claimed on the purchase of IT equipment.
- Relief for tax losses brought forward from prior periods.

2. PENSION CONTRIBUTIONS

Atos UK has a number of defined benefit pension schemes. Over 70% of these schemes relate to employees that have been "TUPE'd" to Atos UK as part of taking on public sector contracts. As at 31 December 2012, these schemes were in a net deficit position of around £125 million, which Atos is responsible for addressing through making excess pension contribution payments.

Under UK tax law, corporation tax relief is given for pension contributions actually paid into pension schemes as opposed to the profit and loss (P&L) expense. In the long term the pension contributions paid will equate to the P&L expense, however in the meantime there will be timing differences between these amounts.

During the year ended 31 December 2012 the P&L expense in relation to the defined benefit pension schemes amounted to around £22 million, however the contributions actually paid amounted to £42 million. This resulted in the company being entitled to an additional £20 million tax deduction in addition to its P&L result for 2012.

Further details of the defined benefit pension schemes are disclosed in the published 2012 financial statements of Atos IT Services UK Limited, which can be obtained from Companies House.

3. CAPITAL ALLOWANCES

Under UK tax law, tax relief is available for the purchase "plant and machinery" that is used as part of a trade in the form of capital allowances. Relief is available at 18% of the cost on a reducing balance basis. If the relief is not able to be utilised in any year (eg if there are not sufficient taxable profits) then the balance is carried forward (with relief still limited to 18% of the carried forward balance). On the other hand, no tax deduction is allowed for the depreciation charged to the P&L in relation to the equipment purchased. In any

one tax year, the difference between capital allowances claimed and depreciation is a timing difference between the PBT and taxable profits.

Atos UK has been in a position for a number of years where the profits have not been high enough for the group to claim its full entitlement to capital allowances, so these have been carried forward as explained above. As such, by the start of 2012, Atos UK had nearly £400 million of capital allowance “pools” carried forward, on which tax relief of 18% was available. This represents the unclaimed cost of investment in plant and machinery by Atos UK.

For 2012, capital allowances of around £72 million were available, however only half of this entitlement will be required as there are insufficient taxable profits to require a full claim.

4. TAX LOSSES

Under UK tax law, if taxable losses are incurred, these can be carried forward and off-set against future taxable profits arising from the same trade.

During 2011, the Atos group purchased the IT services division of Siemens; Siemens IT Solutions & Services Limited (now Atos IT Solutions & Services Limited). Following acquisition, a number of adjustments were necessary to the contracts accounted for by Siemens in order to align the accounting policies with the Atos group. These adjustments resulted in losses being recognised following the acquisition, which meant tax losses arose. The sole driver for these adjustments was alignment of accounting policies.

These tax losses are available to be carried forward and set against any future profits arising from the trade purchased from Siemens. There were such profits in 2012, so the brought forward tax losses have been utilised to this extent. This is therefore another timing difference which resulted in there being no taxable profits during 2012.

29 November 2013

Written evidence from G4S

During the hearing on *Managing government suppliers* on 25 November, the Chair referred to a Statutory Instrument relating to the contract for electronic monitoring:

Q74 Chair: ... [Buddi] has been trying to compete with the tagging on police services up and down the country. She cannot even enter the competition because we have a statutory instrument that defines the responsible officer for providing the tagging equipment. That statutory instrument states that the responsible officer has to be either G4S or Serco. In a statutory instrument laid down by us in Parliament, we are deliberately preventing what appears to be a perfectly bona fide good SME from competing.

G4S has responded to this point with the following:

There are three Statutory Instruments pertaining to G4S specifically (which also include Serco). I've included the links for each of them below:

<http://www.legislation.gov.uk/uksi/2008/2768/contents/made?text=G4S#match-1>

<http://www.legislation.gov.uk/uksi/2009/2950/contents/made?text=G4S#match-1>

<http://www.legislation.gov.uk/uksi/2008/2713/contents/made?text=G4S#match-1>

As you'll note, they are regarding the contracts we currently undertake, but will not be doing so from early 2014. The Statutory instruments basically outline which areas we are the licence holders for and which Serco hold the licence for—this SI would presumably change at the point of the contract being managed by another entity. They don't relate to, as may have been suggested to Mrs Hodge, any rules meaning that we are guaranteed to win a contract.

27 November 2013

Written evidence from the Cabinet Office

Following the Public Accounts Committee hearing on 25 November 2013 the Cabinet Office agreed to provide the Committee with further information on three main points. This note seeks to provide the detail requested and builds heavily on input from the relevant Departments.

PERSONAL INDEPENDENCE PAYMENTS, DWP

DWP awarded the contract for Personal Independence Payment (PIP) assessments to Atos on 31 July 2012.

Government subsequently tightened the approach to procurement to ensure that past performance could be taken into account when awarding new work, a policy that was enacted through a Procurement Policy Note published on 08 November 2012.¹

The PIP contract then went live on 08 April 2013, but was not subject to the new performance policy as the contract had been awarded some three months before this was introduced. Were a similar contract to be retendered today it would be covered by the new policy.

WORK CAPABILITY ASSESSMENTS

Work Capability Assessments have been outsourced since 1998 and have been carried out by Atos since 2005.

Performance has been concerning and the Cabinet Office (and particularly the Crown Representative for Atos) has been involved supporting officials in DWP.

On 22 July 2013 the Parliamentary Under Secretary of State updated the House of Lords, noting that DWP had identified things that were “contractually unacceptable” and that the Department would “apply all appropriate contractual remedies to ensure quality and value.” Atos were instructed to enact a quality improvement plan, that included measures such as retraining and re-evaluating all Atos healthcare professionals.

On 06 September 2013 a new tender was published to procure additional capacity to support the Work Capability Assessment process. The hope is that additional capacity can be brought on stream in 2014. Full details of the tender are available online at the following link: <http://ted.europa.eu/udl?uri=TED:NOTICE:299218-2013:TEXT:EN:HTML>

STATUTORY INSTRUMENTS, ELECTRONIC MONITORING

The Ministry of Justice have confirmed that Statutory Instruments are used to provide successful bidders with the legal powers necessary to deliver the core Electronic Monitoring service. These SIs have no impact on the competitive process and do not affect any firms ability to bid for work during the competition.

One of the key Statutory Instruments was issued in 2001 and subsequently updated². Following the tender process and award of the contract this gave the two successful bidders the authority to carry out the service in the regions they had successfully competed for: Securicor (now G4S) and Premier Monitoring Services (a trading arm of Serco Group).

The Statutory Instrument in no way limits Government’s ability to change the way services are procured, as demonstrated by the latest competition that MOJ are currently running for Electronic Monitoring. This disaggregates contracts into smaller lots to help attract a diverse range of bidders, most notably by having 4 separate lots: electronic monitoring field service and platform integration; software; hardware; and networks. No bidder will be able to win the first of these lots and the hardware lot, helping ensure innovative hardware suppliers have a fair chance to compete and offer innovative solutions.

3 December 2013

Written evidence from the Ministry of Defence

Question 91—111 *Ministry of Defence*

As there have been issues with the IT supporting our new recruitment model, we have put some additional manpower resources into the recruiting operation being delivered by Capita. This means that while we are fixing the IT issues we can deliver a manual work-around. Most of the additional manpower is from personnel hired by Capita at a cost of £3.3M to the MOD. The team has also been reinforced with 8 military personnel with no additional cost to the MOD.

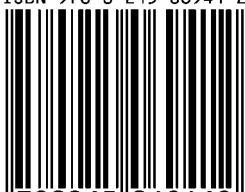
Separately, the Chief of the General Staff has decided to divert some of his resource to delivering Army 2020, including around 100 regular military personnel who have been attached to the Army’s central recruiting team on a full-time basis and 800 regular military personnel who are on-call to reinforce Reserve units and provide increased presence at recruiting events that are taking place around the country. The reprioritisation of military manpower incurs no additional cost to MOD.

4 December 2013

¹ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/80220/PPN_Taking_Account_of_Bidders_Past_Performance_08-11-12_1.pdf

² Statutory Instrument 2001 No. 2233 (Electronic Monitoring (Responsible Officers) (Amendment) Order 2005)

ISBN 978-0-215-06941-2



9 780215 069412



Printed in the United Kingdom by The Stationery Office Limited
3/2014 37252 19585