Variations
Best Practice Guidance Note

Introduction

1. The aim of this Best Practice Guidance Note is to assist Trusts in managing variations to PFI Projects. Though the Note is drafted with Schedule 22 of the Department of Health Standard Form PFI contract (v3) ("SF3") in mind, its contents are equally applicable to Trusts with contracts pre-dating SF3. The Note has been developed from experience gained on PFI projects over a number of years, both during procurement and operation of those projects. It therefore contains guidance that is relevant both to Trusts in procurement and in operation. This Note should be read in conjunction with latest HMT Guidance on variations in PFI projects[1].

2. It covers guidance on:

    - managing the variation process; and
    - validation and calculation of costs.

3. Separate business case guidance is being used to complement this Guidance Note, which does not therefore deal with business case approval or delegated limits issues.

Managing the Process

Resource

4. Robust management of the variations process is essential for Trusts to ensure timely implementation of those variations and to achieve value for money from the process.

5. In light of this, Trusts must give careful consideration to amount of resource allocated to the management of PFI contracts following Financial Close. It is easy to view Financial Close as the end of the process, when in fact it is the just the beginning of a long-term relationship with Project Co. The amount of resource required will vary depending upon the size and complexity of the PFI Project. The NAO report "Managing Changes in Operational PFI Projects"[2] recommends that PFI projects should be managed by the equivalent of at least one full time person on the public sector side and that more should be involved for larger projects or projects where many changes are anticipated.

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[1] See HMT Standardisation of PFI Contracts (SOPC) v4, Change Control Principles Paper (August 2007) and HMT Operational Taskforce Note 3: Variations Protocol for Operational Projects available at http://www.hm-treasury.gov.uk/documents/public_private_partnerships/ppp_index.cfm

[2] NAO report: Making Changes in Operational PFI Projects published 17th January 2008 available on the NAO website at http://www.nao.org.uk/home.htm

6. One full time person should be considered the bare minimum resource for operational PFI projects. In all but the very smallest projects, more people will be required. Trusts should map out all the activities involved in monitoring the project and then match the appropriate resource to each activity. Consideration also needs to be given to any specialist expertise needed as such needs may necessitate additional people on the management team.

7. There will also be links between the Trust and Project Co outside the dedicated Project team. Direct links to the Trust finance department, at clinical working level and at Chair/Chief Executive level are standard. In view of this, the Trust must clearly define how these structures work, to ensure that staff know who does what.

Contract Guides

8. Trusts should also consider producing a simplified contract management guide[3] to help staff understand the key elements of the project, including the variations process. The guide should be adapted to the Trust's own internal management processes and should identify:

    - key stages in process
    - information required at each stage
    - personnel who need to be involved/sign off at each stage
    - links to the Trust's Standing Financial Instructions
    - links to DH/SHA approvals process[4]

9. A number of existing projects have identified clear benefits from translating Schedule 22 into a simple guide for everyday use, in terms of both management of Trust internal processes and management of the variations process with Project Co.

Robust Management

10. Use of a simplified guide to variations must be coupled with robust management of the process. In line with the Trusts' own internal reporting and governance arrangements, it is obviously important for Trust staff to be aware of the internal process for initiating a variation. However, those managing the process at the Trust must also ensure that all staff requests are properly evaluated before being progressed with Project Co. For example, Trust staff requesting a variation may use the Helpdesk as their first port of call. All such requests will need to be filtered and re-routed to the appropriate Trust representative for evaluation before they go any further. Only those variations that have

[3] See HMT Operational Taskforce Note 2: Project Transition Guidance for further advice on managing operational projects
http://www.hm-treasury.gov.uk/documents/public_private_partnerships/ppp_index.cfm
[4] Revised business case guidance for variations is due to be issued shortly.

been approved at the appropriate level within the Trust should be issued to Project Co.

11. Trusts should agree with Project Co a single point of contact on each side to deal with variation requests to ensure that both parties deal with them at the appropriate level. Steps such as these should help to reduce wasted costs on both sides; address some of the concerns raised by the private sector on the quality of variation requests issued by Trusts; and improve the quality of response received from Project Co. (See below for more detail on this).

12. Trusts should also consider a moratorium on variations for a fixed period after moving into new facilities. This will give both Trust and Project Co staff time to adjust to the new premises and new ways of working before assessing whether changes are required.

Cost Analysis

13. Costs information provided by Project Co must be analysed properly to ensure it follows what is set out in the contract (see section 3 of this Note for more guidance on costs). It is vital that that Trust staff managing the variations process fully understand what is already covered by the contract, so that the Trust does not pay twice for something. Trusts should also keep accurate records of each variation, for the same reason.

Trust Approach to Variations

14. Trusts need to be realistic in their approach to variations and be aware of issues that will cause delay in the process and/or increase costs and risk to the Trust. If all these issues are not properly considered by the Trust before it issues its Variation Enquiry, it increases the possibility of Project Co's Response being unrealistic or unaffordable. To avoid this, the Trust's internal management process should require sign-off of all Variation Enquiries at an appropriately senior level before issue to Project Co.

15. Trusts should also give due consideration to the use of external legal, financial and technical advisors to advise on the issues set out below and factor the costs of doing so into the budget allocated for the variation.

16. As a rule, variations during construction should be avoided unless absolutely necessary, due to the increased risk of delays and potential compensation events for the Trust. An exception to the rule may be made where the construction period on a particular project is unusually long. In general, though, more time taken in agreeing design prior to Financial Close (an approach that will be required under new procurement regulations in any event) should reduce the need to make changes so early in the life of the Project.

17. A Trust introducing variations during operation must assess such things as:

    - interdependencies with the existing building and risk of impact on availability of that building;
    - (for an Additional Works variation) the impact of introducing an additional construction period into the project and access terms for construction post Completion of the main build;
    - the impact even small variations can have on the project whole life cost.

18. Trusts also need to understand the types of issues about which the project funders will be concerned and to be aware of the financial threshold above which Project Co has to notify them about a variation. Involvement of the funders in the variation process will have an impact upon the cost and timetable for implementation of the variation. It should be possible for Project Co to provide this information to the Trust. It may even be helpful for the Trust to be involved in approaching the funders with Project Co, should funder approval be required. Agreeing a protocol with Project Co for dealing with funder issues could help to reduce cost and delays to the process.

Contents of a Variation Enquiry

19. From a Trust perspective, the key information that needs to be provided to Project Co is the reason for the variation and the Trust's expectations in terms of outcomes and the benefits it will bring. This should enable Project Co, using its existing knowledge of Trust estate, to respond to the Variation Enquiry in a way that delivers the required benefits in the most cost effective, least risky way. Discussions with the private sector has suggested that, in support of this general information, Trusts need to provide the following minimum level of specific information in a Variation Enquiry to enable Project Co to provide a timely and realistic estimate of the cost and impact of the requested variation under Stage 1 of the process set out in Schedule 22:

    - for a Works variations, mark ups to "As Built" drawings are easier for Project Co to assess than new drawings produced by Trust architects and, therefore, should help to keep costs down;

    - for Works variations, details of what the space is to be used for;

    - construction standards required, bearing in mind that for Additional Works, the Construction Contract will no longer be in place;

    - FM service levels required

20. A number of Trusts have raised concerns that they would not be in a position to present that above level of detail in a Variation Enquiry without input from Project Co. Therefore, Trusts can consider agreeing an interim stage with Project Co before Schedule 22 is formally triggered, during which Project Co will provide this input at a pre-agreed rate. However, it must be clear that any input provided by Project Co at this stage will not result in the Trust retaining additional risk. Project Co must still respond to the Variation Enquiry in accordance with the procedure set out in Schedule 22 (or such other pre-SF3 process).

Initial Estimate Protocol

21. Whilst in normal circumstances, enquiries should be properly assessed before issue to Project Co and speculative enquiries should generally be avoided, the nature of the health service does mean that Trusts will always need to react quickly to proposed NHS/DH policy and/or service changes some of which may not be implemented. Therefore, it may be helpful to Trusts to agree a protocol for Project Co to respond at its own cost with an agreed level of detail to a limited number of such enquiries each year.

22. If the Trust furnishes the agreed amount of detail to Project Co for these types of changes, it would be reasonable for Project Co to provide a realistic indication of the following (including details of the basis upon which any figures are calculated, e.g. costs per m^2) without charging the Trust:

- Cap Ex
- impact on FM
- insurance impact (yes/no)
- Whole Life Cost impact (yes/no)
- timescale for implementation

together with reasonable estimates for transaction costs such as:

- costs of re-running the Financial Model (where appropriate)
- Funder’s costs
- legal costs

Costs

23. The aim of this section is to support the existing provisions of Schedule 22, addressing such things as validation of Project Co costs; the inclusion of Project Co mark ups on costs; the basis of valuation of Works variations; treatment of lifecycle and the concept of Small Works. However, as before, the general principles are equally appropriate for pre-SF3 projects.

Validation of Costs

24. It is essential that Trusts validate costs proposed by Project Co for variations. The NAO Report[5] recommends that the public sector employ more robust techniques to validate costs and raises concerns about the inconsistencies in pricing of similar items across the different projects. Given the fact that for all but the largest variations, the Trust is effectively undertaking a single tender procurement, it needs to employ stringent methods to validate the costs proposed. A number of validation methods can be used, depending upon the size and complexity of the variation.

25. Small Works can be pre-priced on, for example, an annual basis by reference to an existing industry-pricing schedule such as SPONs or the BMI Price book. Trusts should also establish whether Project Co onsite staff would be carrying out this work. It would be reasonable to assume that Project Co will have an onsite presence for which the Trust is already paying. In which case there should be no additional labour charges for Small Works. If the schedule of Small Works includes work that would require specialist labour, these rates should also be agreed in advance.

26. For other variations that are not capable of being completely pre-priced, but may be too small to be competitively tendered, the Trust should engage its own Quantity Surveyor to check costs. The Trust's QS can also be used to audit costs on an ongoing basis from a selection of variations to ensure consistency and value for money are maintained. Latest HMT Guidance[6] suggests that even with these mid-range variations, anything that can be pre-agreed should be. For example, rates for the use of specialist labour; costs of materials (to be derived as before from SPONs or BMI indices); agreed allowances for professional fees and use of Project Co staff in preparing the Response.

27. Larger variations should generally be competitively tendered by Project Co to ensure that Project Co can demonstrate value for money. Schedule 22 currently suggests a trigger for competitive tendering of £100,000 (capital expenditure), though it is subject to determination on a Project specific basis. The HMT Operational Taskforce Note 3[7] contains further advice on competitive tendering of high value changes and also suggests the use of benchmarking or the joint appointment of an Independent Technical Advisor as an alternative means of establishing value for money.

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[5] NAO report: Making Changes in Operational PFI Projects published 17th January 2008 available on the NAO website at http://www.nao.org.uk/home.htm

[6] See HMT Standardisation of PFI Contracts (SOPC) v4, Change Control Principles Paper (August 2007) and HMT Operational Taskforce Note 3: Variations Protocol for Operational Projects available at http://www.hm-treasury.gov.uk/documents/public_private_partnerships/ppp_index.cfm

[7] HMT Operational Taskforce Note 3: Variations Protocol for Operational Projects available at http://www.hm-treasury.gov.uk/documents/public_private_partnerships/ppp_index.cfm

Project Co Mark Ups

28. Experience gained from existing PFI projects suggests that further guidance is required about the basis of calculation of the cost of a variation. It has become common practice for certain sums to be automatically included by the private sector without any specific justification. The most common example is the inclusion of a mark up at Project Co level on the actual subcontractor costs of implementing the variation (often referred to as a “management fee”). Such a mark up is only justified where Project Co is providing a genuine service as part of the process. Where Project Co simply acts a post box for correspondence between the Trust and the relevant subcontractor carrying out the work, a mark up is not justified.

29. In light of this, we would not expect to see such mark ups on any Small Works variations. For larger variations where Project Co staff may be more involved in the process a specific mark up or allowance may be appropriate to cover those costs. However, these sums must be justified on a case-by-case basis. Where Project Co claims a mark up to cover increased performance risks or interface risks Trusts should obtain specialist technical and financial advice to validate the sums claimed and ensure that such risks have not already been priced in, for example in the calculation of the revised UP. Again, the HMT guidance referred to above contains further advice on this issue.

Insurance Costs

30. It also seems to be common practice to include insurance costs for every variation. The Project insurance documentation agreed at Financial Close will detail events that trigger an increase in insurance premiums. Therefore, insurance costs also need to be justified by Project Co on a case-by-case basis, with Project Co providing evidence of the cost increase and the basis for that increase.

Lifecycle

31. Treatment of lifecycle costs has been inconsistent across PFI projects. Once again, these costs should be considered on a case-by-case basis rather than by means of a standard mark up to the cost of the variation. Again, Trusts should consider the appointment of technical advisors to advise on existing lifecycle provision in the Financial Model and the impact of any variation.

32. For many Small Variations it may not be appropriate to add an additional lifecycle cost. Similarly, with variations requested late in the life of the project it may not be necessary to consider much in the way of lifecycle.

33. Additional lifecycle costs are not the only consideration. It is possible that work carried out as part of a variation may remove the need to carry out certain scheduled lifecycle works in the future. This should result in a saving for the Trust.

34. It has been suggested that Trusts might actively consider the inclusion of certain work as part of a variation (e.g. commissioning re-decoration) to take advantage of efficiencies of scale and thereby remove the need for the scheduled lifecycle work later. This option is always open to Trusts, though only if the inclusion of this additional work can be agreed in a cost effective and timely manner as part of the variation process. The latest NAO report suggests that agreement of lifecycle costs has often caused delays in the variation process and therefore recommends that consideration of these costs be taken out of the variation process and bundled together, with adjustments being made to the UP on a six monthly or annual basis instead, as a way of speeding up the process. However, the Trust would need to be satisfied that it was not exposed to any additional risk by leaving these costs outstanding at the date the variation is agreed.

Pricing of Works Variations

35. Schedule 22 assumes that the cost of Works variations will be calculated using the methodology for valuing variations set out in the Construction Contract. However, a review of recently closed projects has shown that the Construction Contract often contains little detail on actual methods of valuation. Trusts in procurement must have a clear understanding before final bids of the method that will be used to value variations.

Small Works

36. Small Works are currently defined in Schedule 22 as being works of a minor nature that do not exceed £1,000 (index linked). This figure is subject to adjustment on a project specific basis. Trusts may want to consider expanding this concept to improve flexibility within their own projects. For example, the Small Works threshold can be increased to £5,000 (to tie in with the threshold for classification as an asset). Latest HMT Guidance suggests an even higher threshold of £10,000. Alternatively, Trusts could list standard times of work that they anticipate will be carried out in any year and agree an annual budget to cover those items, with the unused balance being rolled over into the next year. Trusts could use a combination of the two. The main concern will be to ensure that value for money is obtained from whichever method is employed. Therefore, Trust should always be agreeing costs for these works in advance and validating them in accordance with the methods referred to above.

Information Sharing

37. One way in which the Trusts can improve their position in managing the variations process and validating costs proposed by the private sector is to compare costs and best practice across all projects in the NHS. To assist in this process, we have established a closed website “PFI in the NHS” on which Trusts can share information, post requests for assistance and generally share experiences on all issues relating to their PFI projects. Invitations to join this website will be sent out on request to Trust PFI representatives. For more information please contact Brian Saunders or Sarah Brooke.

DH Private Finance Unit
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