

FRANCES BAARD DISTRICT MUNICIPALITY



CONTRACT MANAGEMENT POLICY

FIRST DRAFT

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1. DEFINITIONS & ABBREVIATIONS

PPP	Public-Private Partnership / Public-Public Partnership
MFMA	Municipal Finance Management Act
MSA	Municipal Systems Act
CBO	Community based and non-governmental organizations
ToR	Terms of reference
SLA	Service Level Agreement
LM	Local Municipality
FBDM	Frances Baard District Municipality

2. POLICY OBJECTIVES

The policy has the following objectives:

- To ensure that all contractors are employed in accordance with recognized standards in the Municipality.
- To provide guidance on aspects of contractor selection, management and monitoring of contractors and the legal issues pertaining to contract implementation.

3. CONTRACT MANAGEMENT

3.1 GUIDING PRINCIPLES

These guiding principles are intended to assist the Municipality in choosing the most appropriate service delivery mechanism for its communities. It is listed as follows:

- Accessibility of services (i.e. regardless of race, gender, disability etc);
- Affordability (including pro-poor tariffs, appropriate service levels depending on economic sustainability and cross -subsidisation);
- Quality of products and services;
- Accountability (Council must remain accountable);
- Integrated development (i.e. poverty alleviation, job creation, etc. to be taken into account);
- Sustainability (financially and environmentally);
- Value-for-money (i.e. both the cost of inputs and quality and value of outputs) ;
- Ensuring and promoting competitiveness of local commerce and industry;
- Promotion of democracy.

This policy recognizes the need for a change in municipal service delivery, due to the overwhelming need to develop the social, economic and material circumstances of communities and to meet their basic needs.

3.2 BENEFITS OF OUTSOURCING

The prime benefit of contracting out is that this can offer economies of scale (i.e. offer better value-for-money) and provide better specialist expertise and experience than can be offered by the Municipality. In simple terms, this could be summed up as potentially offering the service better and cheaper.

However, the important prerequisites in outsourcing are that the Municipality ensures appropriate risk transfer (i.e. avoiding an unequal contract to the detriment of the Municipality) and effective contract management and monitoring (i.e. ensuring, inter alia, that the municipality retains accountability).

3.3 RISKS OF OUTSOURCING

Risk has been defined as any factor, event or influence that threatens the successful completion and operation of a project in terms of cost, time or quality.

This means risk covers a wide range of possible events; from a pipe burst, to an interest rate hike to political interference. The risks most commonly associated with public sector projects include, very briefly, political risk, contract variation, cost overruns, poor modelling and projections and bureaucratic management.

Where all, or most, aspects of the municipal service are contracted out the allocation of risk becomes a critical issue. This is because, quite expectedly, the more risk a contractor takes on, the more compensation it will demand from the Municipality. This could be either in the form of money or of added control and autonomy over the service.

An added danger area is that of municipal capacity to manage the tendering, contract development and monitoring of the project. This option is most effective only if the municipality has the capacity to fulfill these functions and thus ensure that municipal objectives are met.

3.3.1 Leases and Concessions

Leases and concessions are contracts most appropriate to municipalities where large-scale capital investment is required. Public sector resources are simply insufficient to meet the significant municipal infrastructure backlog and alternative ways of accessing financial resources need to be explored. Mostly the solution lies in a partnership of the public and private sector.

However, if poorly managed and structured, the risks of these partnerships are high. These potential risks are identified:

- Loss of accountability;
- Prejudice to consumer rights;
- Monopoly pricing;
- “Cherry-picking” high-income end users (to the detriment of the poor);
- Poor quality services ; and
- Unfair labour practices.

Because of the seriousness of these risks, there was a need for national government to develop a regulatory framework for Municipal Public-Private Partnerships. These Municipal PPP Regulations went into effect on 1 April 2005.

The areas that are being regulated include:

- Monitoring;
- Oversight and consultative mechanisms;
- Tendering and procurement processes;
- Contractual arrangements;
- Regulation of tariff setting and
- Resolution of disputes.

This policy acknowledges that the following categories of risk apply to PPPs, although these may overlap to some extent and are not necessarily comprehensive:

- Construction risk (design problems, building cost overruns, project delays);
- Financial risk (variability interest rates, exchange rates, factors affecting financing costs);
- Performance risk (availability of an asset, continuity and quality of service provision);
- Demand risk (need for services).

Section 120 of the MFMA covers the conditions and process for PPP's. The Municipality must comply with Chapter 8 of the MSA when the PPP involves the provision of a municipal service. Both the MFMA and the MSA make the appropriate transfer of technical, operational and financial risk an essential factor to be considered in any outsourcing process.

3.3.2. Risk Transfer

Risk transfer can be regarded as both a possible benefit of outsourcing and, at the same time, as a potential danger area requiring careful consideration and treatment.

On the benefit side, if risk is allocated appropriately then the municipality operates in a more certain environment as it knows its costs ahead of time. It therefore enjoys the advantage of being able to budget and plan ahead more effectively.

Also, in certain cases, such as a large construction project, a municipality is not necessarily ideally suited to bear all the related risks with a project of this nature. Managing the risks associated with a large construction project would not fall within the scope of the normal day to day operations of a municipality and would thus arguably be better suited to a private sector entity experienced in these projects. It is suggested that key risks, which should usually be transferred to the private sector include construction cost, completion risk and operational risk.

On the danger side, inappropriate transfer of risk could have a disastrous impact on a municipality. An ill-considered transfer of risk could put the municipality at undue financial risk and have a negative knock-on effect on

value for money and affordability. Risk transfer is important as the more risk a contractor is forced to take on, the more compensation it will demand. Compensation could be in the form of more money, alternatively it could mean the contractor demands more autonomy in the contract.

Risk transfer is therefore not simply about the municipality trying to push as much risk the contractor's way as possible. It is about finding the right balance, which may differ in each case, between the cost of risk and where it is most appropriately placed.

The appropriate allocation of risk is therefore a complex and thorny area and would have to be the subject of careful negotiation between the parties. The allocation of risk should therefore be appropriate to the respective duties each party is taking on and would vary depending on the nature and length of the contract in question.

3.4 CHOOSING A SERVICE PROVIDER

Whenever the Municipality needs to appoint a service provider, the choice involves a set of principles to be applied. The nature of the service to be rendered will dictate the category of service provider needed. The possible external service providers recognized in legislation are listed below:

- Community based and non-governmental organizations;
- Municipal entities ;
- Public sector providers and
- Private sector providers.

3.4.1 Community Based and Non-Governmental Organizations

Community based and non-governmental organizations are recognized by the Systems Act as potential external service providers. The proviso is that the organisation must be legally competent to enter into an agreement.

In other words a CBO cannot merely comprise a loose grouping of community members. The community is obliged to organize themselves into a more formal structure with legal capacity to enter into agreements. This means that the actual legal structure of the organisation could take many different forms including a company, an association, a trust, a partnership and so on.

Contracts with CBO's are mostly well-suited to skills transfer. The CBO contract is typically focused on social upliftment and local economic development. This could result in the Municipality contracting with a less skilled external entity.

If this is so, then the Municipality should ensure comprehensive contract support and monitoring, with the Municipality retaining more risk than it would in other service delivery agreements.

The CBO may not start the contract with pre-existing specialist service delivery skills. The contract should then be more focused on clearly defined inputs rather than outputs (contrary to most PPPs) with the possibility of this changing as the CBO gain more experience and expertise in the particular service area.

3.4.2. Municipal Entities

Although entirely separate from the municipality, the municipal entity is tightly regulated by both the MSA and MFMA. The Systems Act sets out detailed statutory duties and responsibilities governing a municipality if it decides to establish a municipal entity.

When choosing a municipal entity as a service provider, the Municipality retains accountability for service provision and the success of the municipal entity despite the fact that the Municipality has outsourced the function.

The municipality is explicitly obliged to ensure the municipal entity is managed responsibly and transparently, and meets its statutory, contractual and other obligations. It must also ensure that there are clear channels of communication between the Municipality and the municipal entity. The MSA provides that the official line of communication between Municipality and the entity operates between the Chairperson of the Board of Directors and the Mayor of the entity and the Municipality respectively.

A variety of provisions oblige the Municipality to ensure that performance objectives and indicators are both established and met, that effective monitoring takes place, that effective and fair procedures are put in place for the appointment and removal of directors and that measures are in place to ensure effective governance of the municipal entity generally.

3.4.3 Public Sector Providers

Public sector providers could take a number of forms, including national or provincial organs of state, traditional authorities, water services committees and licensed service providers recognized in national legislation.

As the Municipality does not own or exercise any control over the public entity, issues such as reporting and monitoring, continuity of service and continued accountability on the part of the Municipality need to be thoroughly covered in the contract when a public entity is chosen as a service provider.

The fact that a public sector provider is typically not profit driven means the contract would not have to put mechanisms in place to prevent profit motives prejudicing other objectives of the contract, such as affordability, life-line tariffs and the like. The public sector provider is also likely to possess excellent skills and expertise in its particular service sector.

It is important that the Municipality put mechanisms in place to ensure skills transfer from the public sector entity to the Municipality. Also, because the entity is already publicly focused, the risk of a lack of public buy-in is (in theory

at least) lessened. It is therefore unlikely to be necessary for this external entity to perform specific community projects as found in some private sector contracts (such as building soccer fields or libraries and the like).

3.4.4 Private Sector Providers

The private service provider is, quite simply, any private institution, be it a company, close corporation, partnership or the like, which is legally competent to operate a business activity.

Contracting with a private company represents a true arm's length relationship, which will require a contract leaving no doubt regarding the parties' respective roles, strict reporting and monitoring provisions and a very clear delineation between the parties' roles as "authority" and "provider" respectively. The importance of allocation of risk is highest with this entity.

It would be inappropriate for a private company to exercise veto power, or even undue influence, over the Municipality's duties regarding the approval of policies, strategies and future decisions regarding service delivery. This is because the company's accountability is ultimately to its shareholders and it could well have an interest in extending a contract for as long as possible (so long as the contract is profitable) or of amending the contract to its advantage.

The Municipality must ensure that it has the capacity to take over service delivery at the end of the contract period and is not locked in to using the private company indefinitely.

As the use of a private company comes closest to the concept of true "privatization" and is often a tough sell to the community affected (who fear tougher credit control methods and tariff hikes) the contract will need to ensure that steps are taken to try and ensure public buy-in, to allay fears and to achieve excellent communication channels between the consumers and the service provider.

The contract will include provisions obliging the company to dedicate money to community upliftment projects (such as funding social projects or building community facilities) and to the use of local labour wherever possible.

3.5 FEASIBILITY STUDY

The municipality is obliged to conduct a detailed feasibility study and the results of this study must be taken into account when the Municipality makes its decision on whether to use an internal or external service delivery mechanism.

The feasibility study must include the following matters:

- A clear identification of the service in question;
- The number of years the service is likely to be outsourced;
- Projected outputs;
- An assessment of how the outsourcing will provide value for money;
- How it will address the needs of the poor;
- How it will be affordable;
- How it will transfer appropriate technical, operational and financial risk and
- An assessment of the impact on staff, assets, IDP and budgets

The feasibility study is intended to prevent the Municipality from rashly deciding to go ahead with outsourcing without carefully considering the future impacts of the decision, specifically in the context of the needs of the poor, affordability, value for money and appropriate risk transfer.

The requirements of the feasibility study imply that the decision to outsource cannot be made solely on commercial principles, but must also take place within a wider context of the Municipality's constitutional obligation to give priority to the basic needs of the community.

To fully comply with the requirements of the feasibility study requires the Municipality to complete a relatively complex study. The MSA therefore includes a provision allowing national or provincial government to assist both in carrying out the feasibility study, and in preparing service delivery agreements.

Any assistance national or provincial government may offer is subject to an agreement between the municipality and the other organ of state, so that the MSA does not allow national or provincial government to become involved without the consent of the municipality.

3.6 THE CONTRACTING PROCESS

The key elements of a thoughtful contracting process are the following:

- Strategy development
- Evaluation
- Selection
- Negotiation
- Implementation

3.6.1 Strategy development

It is important for the Municipality to adopt a strategy pertaining to the acquisition of a service delivery mechanism. This policy advises that the Municipality outlines the Terms of Reference for the service to be provided.

The ToR would typically be constituted by the following elements:

- Programme objectives and description
- Aspects of tender from the service provider
- Plan of work and methodology
- Sources of information
- Deliverables of the programme
- Required expertise of the service provider
- Time schedule
- Management structure and reporting
- Tender adjudication
- Contact details of the Municipality
- Confidentiality clause

The ToR should be advertised in the mainstream printed media in order to reach service providers on an equal footing.

3.6.2 Evaluation

Upon receipt of tender documentation from service providers, the Bid Evaluation Committee will start the evaluation process.

The Bid Evaluation Committee will scrutinise the tenders as follows:

The Committee will check for completeness and conformity with the precise instructions and conditions of the ToR, which check must include, inter alia:

- Completed standard tender forms
- Price calculations
- Required validity periods
- Acceptable escalation requirements
- Acceptable foreign currency requirements
- Acceptable commercial terms and conditions

- Prices / rates for services where applicable
- Inclusion of costs for transportation and packaging as applicable
- Inclusion of Erection / Installation / Commissioning costs as applicable
- Adherence to Tender Board requirements
- Prices included for manuals where requested
- Acceptable delivery periods have been quoted
- Negotiate terms of payment in the event of foreign currency elements being included

At this stage, service providers who do not pass the evaluation criteria will be disqualified.

3.6.3 Selection

The Bid Evaluation Committee will short list and then a selection will be made based on set criteria.

The criteria for the selection of the successful service provider will be as follows:

- Level of expertise in the service provider team
- Reliable, contactable references
- Proven financial sustainability
- Proven experience in similar projects
- BBEE status
- Menu and pricing structure
- Product or service offered
- Membership of the relevant professional organisation

3.6.4 Negotiation

The selected service provider(s) will be invited in writing for contract negotiations. Negotiations may include discussions on any aspects of the proposal and any matter of concern to the Municipality and other consultants / service providers.

This policy furthermore acknowledges the need for negotiating the SLA. An SLA is a formally negotiated agreement between two parties. It is a contract that exists between customers and their service provider, client or between service providers. It records the common understanding about services, priorities, responsibilities, guarantee, and such — collectively, the level of service. For example, it may specify the levels of availability, serviceability, performance, operation, or other attributes of the service like billing and even penalties in the case of violation of the SLA.

After a settlement is reached, the successful service provider(s) will be appointed. Such appointment will be effected with the signing of the relevant contract and other documentation by the stakeholders.

3.6.5 Implementation

The contract implementation phase tests the relevance of contract terms and conditions. This policy acknowledges that certain pitfalls exist when a contract is being implemented and lists them below:

RISK REALISATION: Even if contracts correctly anticipate potential risk events and put in place binding provisions to deal with these events, the contract terms still risk being overridden by the contracting parties acting on other external pressures. This has a potential knock-on effect for affordability and value for money.

CAPITAL INVESTMENT: Long term contracts, such as concession contracts, are more vulnerable to material contract amendment or renegotiation. The results can lead to the watering down of outsourcing objectives, such as the provision of capital for infrastructure projects.

MONITORING: If monitoring duties specifically provided for in contracts are not being conscientiously implemented by the Municipality, it will render the monitoring provisions meaningless.

PUBLIC BUY-IN: Contract provisions attempting to ensure public buy-in, such as the establishment of a Community End User Forum, may be ignored.

POLITICAL WILL: A lack of political will can render contract provisions meaningless if the Municipality chooses not to promote or implement the contract provisions.

This policy seeks to guide the Municipality in such a way that contract implementation pitfalls are either mitigated or totally eliminated.

The Municipality needs to vigorously monitor and control all contracts entered into. Renegotiation of long-term contracts must be done with the utmost sensitivity towards the requirement of transparency, the needs of the poor, budgeting constraints and the accountability of the Municipality.

3.7 TYPES OF CONTRACTS

The Municipality has the following options in terms of contracts:

3.7.1 Corporatisation

The Municipality forms a separate legal corporate entity to manage municipal service provision. The municipality continues to own the enterprise, but it operates with more of the freedom and flexibility generally associated with a private sector business. A "Section 21 Company" is one of a variety of possible forms of corporatisation.

3.7.2 Public-Public Partnerships / Public-Private Partnerships (PPP)

The Municipality enters into an agreement with another public / private entity for municipal service provision. A variety of contracting forms and compensation schemes are possible.

3.7.3 Municipal Debt Issuance

The Municipality issues bonds to raise capital directly from private investors to finance the capital costs of building or expanding an infrastructure system. The municipality maintains total control of the project, and bears all associated risks. The issuance process is usually facilitated by underwriting firms, (public or private banks) and may also involve financial advisory service providers. The typical duration of debt is 10 – 20 years.

3.7.4 Service Contract

The Municipality pays a fee to a private firm to provide specific operational services such as meter reading, billing and collection, and operating facilities. The typical duration is 1 – 3 years.

3.7.5 Management Contract

The Municipality pays a fee to a private firm to assume overall responsibility for operation and maintenance of a service delivery system, with the freedom to make day-to-day management decisions. The typical duration is 5 years.

3.7.6 Lease Contract

The private firm rents facilities from the Municipality and assumes responsibility for operation and maintenance. The lessee finances working capital and replacement of capital components with limited economic life, but not fixed assets, which remain the responsibility of the Municipality. The typical duration is 10 years.

3.7.7 Concession

A private firm handles operations and maintenance and finances investments (fixed assets) in addition to working capital. Assets can be owned by the firm or the Municipality for the period of the concession. Where assets are owned by the firm, they will be transferred to the Municipality at the end of the concession period. The project is designed to generate sufficient revenues to cover the private firm's investment and operating costs, plus an acceptable rate of return. The typical duration is 15+ years.

3.7.8 Build-Operate-Transfer (BOT)

This is a form of concession, with an emphasis on construction of new stand-alone systems. The Municipality may or may not receive a fee or share of profits. The typical duration is 15+ years.

3.7.9 Full Privatisation

The Municipality sells off an asset to a private sector firm.

4. POLICY REVIEW

This policy will be reviewed on a biennial basis.

5. DOCUMENT CONTROL

Any amendments to this policy will be carried out in accordance with the Business Documentation Management and the Document and Data Control procedure of the Municipality.