MANAGING CONTRACTING RISK

A GUIDE FOR NSW GOVERNMENT AGENCIES

This Guide is confidential for NSW Government Treasury Managed Fund Member Agencies.
The NSW Self Insurance Corporation (SICorp) was created through the enactment of the NSW Self Insurance Corporation Act 2004. This Act established SICorp to operate one or more Government managed fund schemes and to enter into agreements or arrangements with other persons to provide services (as agents or otherwise) in relation to the operation of the any Government managed fund scheme.

SICorp's main role is the administration of the Treasury Managed Fund (TMF), which provides cover for all insurance exposures faced by general government sector budget dependent agencies (other than compulsory third party insurance) and other participating public sector agencies.

Suncorp Risk Services (SRS) works with clients across the public sector in NSW providing strategic level risk management consulting services on behalf of SICorp. SRS focus is on addressing issues of a strategic nature that may impact SICorp and/or individual agencies. In doing so, they provide consultancy and research services in the application of enterprise wide risk management and occupational health and safety and injury management.

For more information....
If you would like to discuss this report, please contact:
Name: Gary McCourt
Title: Risk Management Consultant
Phone (02) 8121 0470
Email: Gary.McCourt@suncorp.com.au
This guide is a resource for NSW Government Agencies, providing a Risk Management framework for project work, outsourced services and goods procurement.

*Managing Contracting Risks: A Guide for NSW Government Agencies* outlines the risks inherent in contracting and advises on how to manage those risks.

Think of this document as a *checklist* for drawing-up contracts between your Agency and third parties. Managing the risks associated with contracted work will help your Agency:

- Reduce costs
- Ensure that important opportunities are not missed
- Minimise your risk of litigation and contractual disputes, and
- Get the contracted job done on time, on budget and to your expectations.

Reducing costs and becoming a more active stakeholder in projects will help your Agency meet NSW Government obligations and improve the quality of your services to the public.

The NSW Treasury Managed Fund’s purpose is to provide a service and a framework that will assist NSW Government Agencies reduce the impact of risk exposures and maximise resources available to support their core business. This guide is an extension of that purpose, focussing on the contracting process.

We wish to thank NSW Self insurance Corporation’s, (SI Corp) contracted service provider, Suncorp Risk Services, the Department of Services, Technology & Administration Public Works and Services Division, the NSW Department of Health, the NSW Department of Education and Training, the Roads and Traffic Authority, the NSW Police Force.

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Who should read this guide?

Anyone who has an interest in the contracting process. This guide is for NSW Government Agencies looking to formulate risk-aware contracts with third parties, thereby reducing Agency exposure to unforeseen consequences. This guide is also a comprehensive introduction to the contracting process and may be used as a reference tool by those new to contracting.

More specifically, this guide is for both decision-makers and those advising decision-makers. This includes contract managers, commercial managers, project managers, risk managers, legal counsel, senior management and CEOs.

What is Risk Management?

Risk Management has assumed greater prominence in recent years because prudent managers have recognised the benefits of managing their own risk exposures rather than relying on insurance as the sole method of protection.

The reason is simple - applying Risk Management techniques can substantially reduce the cost of risk. The benefits achieved flow back to Agencies and not into an insurer’s profit margin.

The Treasury Managed Fund is based on the principles of self-insurance and as such, we place high priority on the implementation of sound Risk Management practice.

The components of the Risk Management process include:

1. Identifying exposure to potential losses which may interfere with your Agency’s basic objectives
2. Measuring the above losses
3. Examining feasible alternative techniques for dealing with the exposure
4. Selecting the most appropriate technique(s)
5. Implementing the chosen technique(s), and
6. Monitoring the results to ensure the program remains effective.

Put simply, Risk Management is a proven, simple and efficient method of controlling exposure to fortuitous risks, i.e. those risks which do not present an opportunity for speculative gain.

As a service to the Agencies, the Treasury Managed Fund is able to provide Risk Management assistance in all areas of operation, including the contracting process.

For a general overview of the Risk Management process, see AS/NZS ISO 31000:2009 Risk management – Principles and guidelines
How to use this guide

Use this document as a guideline and checklist when implementing and managing contracts. While this is not a procedural document, there are many benefits in following the suggested procedures and examples.

We’ve assumed that you, as a reader, have a basic knowledge of Risk Management. For those who do not, we recommend reading this guide in conjunction with AS/NZS ISO 31000:2009 Risk management – Principles and guidelines which is available from Standards Australia.

We don’t expect you to read this document from cover-to-cover, since some parts of the document will be relevant to different readers. However, we do recommend that all readers initially read through the Overview.

We’ve included many references to further information throughout this guide and there are many links to further resources in Appendix 1. We’ve also included several examples of possible contract risk scenario in Appendix 9.

Using the online version

This guide is available in PDF format on the Treasury Managed Fund website, RiskInSite, which is located at www.RiskInSite.com.au. (If you are not already registered on this site, click on New Users.)

Using the online version gives you the added advantage of left-side navigation, whereby you can skip to any part of the document instantly. Move through the document using Adobe Acrobat’s navigation at the top of the screen.

If your web browser allows, you can view the document over the web from RiskInSite, or you can download it to your computer by right-clicking on the link and selecting Save Target As....
Chapter 1: Overview

In this section...
Deciding to contract
The contracting framework
Contracting risks
Public Liability and Professional Indemnity
Guideline Tools
Assurance and improvement

Chapter 1 is an overview of contract Risk Management, with which all readers should become familiar. It is an introduction to managing the contracting process and the associated risks. It provides an overview of some of the key aspects covered in the next four sections and references various appendices that provide more detail on selected topics.

1.1 CONTRACTING IN CONTEXT

NSW Government reliance on contractors and suppliers of goods, equipment and services has increased significantly. The two main categories of contracting activity are:

1. Infrastructure projects, and
2. Procurement of goods and services.

There has been a strong trend towards outsourcing to the private sector services that were once provided by Agency personnel. As a result, a growing proportion of Agency budgets are used to fund contracted services.

The key objectives driving contracting activities are varied and include:

- To lower costs - getting the same for less
- To increase efficiency - getting more output for the same cost
- To increase effectiveness - getting the output that you expect
- To improve timeliness - getting what you want quickly and reliably
- To provide non-core activities - getting specialist or irregular services, and
- To reduce operating risks - such as health and safety, environment and public liability by contracting better competencies and having contract terms that might transfer some risks.

In broad terms, the risks involved in contracting are failing to achieve these objectives. Therefore, your Agency needs to become more competent at setting-out requirements for contractors and suppliers and managing the contracting process. The emphasis is for your Agency’s personnel to become proficient procurement and project managers.
1.2 EXECUTIVE MANAGEMENT’S ROLE

Senior managers should approve and support a contracting system that is integrated within your Agency’s overall management structure. The decision to contract is part of that system. The total system might include the following factors:

- Determining the policy and statutory framework
- Establishing a compliance process for legislative and common law requirements, and
- Formulating a Business Case to ensure that the proposed and expected contracting outcomes are consistent with your Agency’s objectives.

Executive management should:

- Establish an adequate contracting process at the conceptual stage, including stages and steps suitable for the contracting activity
- Verify that the contracting process includes appropriate resources with competent personnel. Also essential are clear communications, monitoring and effective documentation (including a Contract Management Plan), and
- Ensure contracting is part of a general management framework to apply across your Agency. This includes Quality Assurance, Quality Improvement, Risk Management and audit processes. An example is the Australian Quality Council’s Australian Business Excellence Framework (ABEF).

FORMULATING A BUSINESS CASE

The initial assessment process is often referred to as a Business Case. Consider a Business Case assessment when there are significant impacts or risks to budget, strategic direction, operations and your Agency or stakeholders. The Business Case should consider expected contracting outcomes and align them with your Agency’s objectives. At a high (or strategic) level, the Business Case should identify and assess major risks that will expose any fatal flaws. If so, you must propose treatments that reduce risks to a tolerable level. Otherwise, the Business Case would recommend not to proceed.

For more information go to:-

Chapter 2: Deciding to Contract
Chapter 5: Assurance and improvement
Appendix 3: Develop the Business Case
1.3 FORMULATING A CONTRACTING FRAMEWORK

Contract management activities commence well before your Agency has established a contract (or agreement) and concludes after the contract is complete.

You will significantly enhance the likelihood of successful contracting outcomes by establishing and implementing a contracting framework. This might consist of two elements - defining the ongoing critical success factors and formulating an appropriate contracting process. These are described in the following sections.

ESTABLISHING ONGOING CRITICAL SUCCESS FACTORS (EXAMPLES)

To ensure a successful contracting outcome, you should:

- Confirm the mission
- Obtain senior management support
- Provide schedules and plans
- Arrange regular consultation
- Obtain the right personnel (in-house/external/specialist)
- Obtain continuous agreement between contracting parties for contracts requiring project management
- Construct a monitoring and feedback process
- Provide plans for troubleshooting, and
- Engage in continuous communication.

A key specific factor for your Agency is to determine the degree of co-management and contractor monitoring operations and then implement that involvement. Agency involvement should increase according to the assessed risk and with contractor inexperience.

All Agencies should formulate a contracting process -- determine what needs to be done, how, in what sequence, by whom and by when.

At a high level, the contracting process has three phases. Each phase can have various steps according to the nature of the activities being proposed.

<table>
<thead>
<tr>
<th>Phase</th>
<th>Activity</th>
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</thead>
<tbody>
<tr>
<td>Phase 1</td>
<td>Plan the contract</td>
</tr>
<tr>
<td>Phase 2</td>
<td>Formulate the contract</td>
</tr>
<tr>
<td>Phase 3</td>
<td>Manage the contract</td>
</tr>
</tbody>
</table>
Your Agency is more likely to have a successful contract when activities are defined and managed according to a logical and structured contracting process that is suitable for the proposed activities. The single most important phase is planning, and it is here that managers can prevent potential problems.

An important management tool for the contract management phase is to establish a Contract Management Plan (CMP). The CMP is a brief summary of the contract/purchasing process that led to the contract and references to source documents. The CMP includes:

- The reason for the contract
- Objectives
- Options considered
- Analysis undertaken, and
- Key assumptions.

The CMP provides relevant Agency staff with a common understanding of the contract requirements.

When the contract is complete, the resulting process needs to be handed over and integrated with Agency operations. This process is called post-contract management and it provides for continuous improvement and process streamlining.

For more information go to:-

Chapter 3: The Contracting Framework

Appendix 7: Create a Contract Management Plan
1.4 MANAGING CONTRACTING RISKS

Your Agency’s first requirement is to understand and implement a structured process to manage contracting risks. This is summarised in the Risk Management process below which reflects AS/NZS ISO 31000:2009 Risk management – Principles and guidelines.

Your Agency’s next requirement is to focus on managing the main risk areas and include appropriate terms in the contract. These three requirements are described below.

1. THE RISK MANAGEMENT PROCESS

Your Agency should identify and assess contracting risks before tendering, before you formulate the contract. For operational risks, this should be before the contract starts, ideally by a joint Agency/contractor initiative required as part of contract conditions.

The Risk Management process can be briefly described as follows:

<table>
<thead>
<tr>
<th>Step</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Establish the context</td>
<td>What is the strategic and operational role of contracting activities in delivering services and products, and in meeting clear objectives and specific performance indicators?</td>
</tr>
<tr>
<td>2. Identify the risks</td>
<td>Identify short and long term risks in all business units and on an organisation-wide level</td>
</tr>
<tr>
<td>3. Analyse risks</td>
<td>Estimate the likelihood and reasonable consequences for each identified risk. Considering the effectiveness of current controls</td>
</tr>
<tr>
<td>4. Evaluate and prioritise risks</td>
<td>Determine risks that might need further treatment and the cost/benefit of doing so</td>
</tr>
<tr>
<td>5. Treat the risks</td>
<td>Take action to reduce risks and record the level of risk retained</td>
</tr>
</tbody>
</table>

Monitoring, consultation and review occur continuously throughout the process.

For more information go to:-
Chapter 4: Contracting Risk Management
Appendix 2: Identify and assess risks
2. Manage the main causes of contracting risks

There are three underlying causes of the most common and major risks found in contracting. Each requires careful management attention and planning. The underlying causes are where there is inadequacy:

1. Scope
2. Choice of contractor (and subcontractors)/supplier, and
3. Monitoring and work review.

Scope problems arise from your Agency failing to specify what was needed to meet its objectives. In this situation, ‘you got what you asked for’. Your Agency either omitted important needs or included unnecessary ones.

Choosing the right contractor/supplier involves finding one with the appropriate attitude, experience and skills necessary to complete the work to a satisfactory level. The required skills and capabilities extend beyond technical aspects to professionalism, safety, communication, reporting, contingency planning, financial status and so on. An effective evaluation and selection process is critical to choosing the right contractor.

Choosing the cheapest contractor is a common reason for failed contracts. Often the cheapest initial bids win an Agency’s tender without considering the full lifecycle cost and value for money. The most cost-effective contract is often not the cheapest since those suppliers have added quality assurance measures in place. You should also consider fixed-price contracts, which may be more expensive initially but save money in the long term.

Monitoring and reviewing contract performance is essential to ensure contract performance is measured against your Agency’s expectations. Aim to identify problems early and re-adjust plans so you can take action to alter, rectify, or financially compensate for changes to the original contract arrangements. Prevent problems and enhance contractor relationships with a timely, accurate and relevant monitoring system.

3. INCLUDE APPROPRIATE CONTRACT TERMS

Contract terms must address identified contracting risks. Contract terms need to adequately respond to potential adverse circumstances caused by:

- The contractor or subcontractors
- The Agency, or
- External factors outside either party’s control.

More specifically, your Agency should address:

- How to deal with the consequences of suspending or terminating the contract or a major breach. This should extend to suitable contractual remedies, for example, indemnities, rectification, compensation and rights to security
- How to deal with variations. Whether sought by your Agency or the contractor, terms need to cover who pays for direct and consequential losses and how the costs are determined, and
- How to deal with insurable losses that affect contract performance.

Insurance requirements and terms need to be determined by experts. Agency-controlled insurance often improves control.
Contractors must provide evidence of commercial and statutory cover for pre-approved insurances and limits. Your Agency needs to have a right in both the commercial and insurance contracts to claim for major losses.

Contract terms need to ensure that your Agency approves proposed material changes to policies, limits and so on. Insurance cover needs to consider the maximum reasonable loss for any one event and an indemnity limit to at least match that loss.

1.5 PUBLIC LIABILITY AND PROFESSIONAL INDEMNITY INSURANCE TOOLS

PURPOSE
The purpose of these guidelines is to assist Agency Personnel to understand indemnity and insurance requirements for vendors, contractors and sub-contractors (herein known as Service Providers).

1: CONTEXT/BACKGROUND
NSW Government Agencies have a need to regularly enter into contracts with third parties for services, consulting and construction works. The requirement for an easily accessible and user friendly guidance document was identified, specifically related to Public Liability and Professional Indemnity levels of coverage, to ensure that the Treasury Managed Fund member Agencies are protected from loss.

The Treasury Managed Fund (TMF) Contract of Coverage May 2008 states in Note 9 on Page 18¹:-

Liability – Every contract (including all building construction, modification or refurbishing contracts) entered into by the TMF agency shall provide for insurance and indemnity from vendors, contractors and sub-contractors indemnifying the NSW Government and the contracting entity for all losses and/or damage arising out of or in connection with the sale, works, products and services which are the subject of the contract, including public liability, workers’ compensation and employers’ liability. This requirement extends to include bid and performance bonds for contract tenders.

The main purpose of Service Providers holding the appropriate insurance coverage’s, is to reduce the risk to the NSW Government that come from engaging in a relationship with such Service Providers.

The paramount risk is that the Service Providers may not have the financial resources readily available to meet their liabilities should something adverse occur during the course of the Contract.

The level of Public Liability insurance required may vary depending on the nature of the activity being undertaken (currently in the range of $5M to $20M). A survey of 8 major Australian insurers elicited amounts of $5M, $10M or $20M when applying for a quote for Public Liability.

2: WHO NEEDS PUBLIC LIABILITY INSURANCE?
Public Liability insurance covers claims arising from personal injury or property damage as a consequence of a breach in the Service Providers duty of care to any third party. Public Liability is particularly important where the Service Provider is engaged by a TMF Agency to provide goods, works and services that interface with the general public and / or the clients of the TMF Agency.

¹ TMF Contract of Coverage, May 2008
Legal liability could arise in the case of Service Providers if an injury was caused on a work site, such as an injury caused by a surveyor’s pegs or contractor’s equipment. In the case of contractors, the liability can also arise during the maintenance/defects liability or post completion construction period of the contract. Liability may also involve operations after construction is completed and be covered by such insurance where this is arranged.

Public Liability insurance generally does not cover liability in relation to:

- Property damage or bodily injury caused by a motor vehicle where the motor vehicle is insured, as bodily injury in this case is covered by compulsory third party (CTP) insurance,
- Injury to the Service Providers employees which, is to be covered by Worker’s Compensation insurance,
- Loss arising from professional services provided by the Service Provider,
- Risks associated with asbestos, and
- Product liability.

Each Policy has the financial limit of indemnity agreed to by the Service Provider, Broker and Insurance Company, arranging the policy. The limit is to the cover for each claim, no matter how many claims are made in one year. The eligibility of claims is based on the time of the incident, not on the time of the claim, with incidents during the period of the insurance being covered. Claims may also be subject to an excess.

In the case of bodily injury claims, the time from the claim to its finalisation may take several years to allow for the injured recovery period, investigations, negations and legal processes. Because of this potential time period, the insurance is categorised as long tail insurance.

2.1 Application to Agencies

Agencies reduce their exposure to loss by requiring Service Providers to have an appropriate level of Public Liability insurance during the course of a contract with the Agency. This protects the Agency in the event the Agency is joined in a legal action with the Service Providers, and the Service Providers do not have the capacity to meet the liability involved. The Agency shall ensure it is noted on the policy as named or joint insured on the policy held by the Service Providers. Also check that the policy has a Cross-Liability Clause.

2.2 Scope and level of cover

The extent of Public Liability insurance cover required should be established for each contract. Minimal cover policies are restricted to accidents involving on-site bodily injury and property damage. More extensive cover, further limiting an Agency’s exposure, is generally required and covers all the contract activities, including off-site fabrication and other activities.

The minimum acceptable Public Liability insurance cover limits shall be established as part of the policy with the insurer. For consultants, it is recommended that a minimum cover level in the range of $10 million.
and $20 million be used. Factors increasing the cover level required include site related work, contract value and size, the risks of the activity to others, contractor size, and type of company. A minimum cover level of $20 million is recommended for contractors. This could be increased to $50 million, where justified by the risks with a particular contract.

SiCorp as the operator of the Treasury Managed Fund may, at its discretion to minimise Liability of the Fund, require Agencies to ensure that Service Providers have high levels of Liability cover.

Where Service Providers are required by the Agency to arrange public liability insurance, the Agency needs to ensure they submit a Certificate of Currency completed by their insurer of insurance broker to confirm that the appropriate cover is in place. However, as policies can be cancelled at any stage, it is prudent to require Service Providers to confirm the currency of a policy at various stages during the course of a contract.

2.3 The Certificate of Currency shall specify:

1) Name of Insured 5) Level of Cover in the aggregate and for each occurrence
2) Policy Number 6) Policy Excess
3) Expiry Date 7) Summary of the cover provided
4) Name of the insurer 8) Jurisdictional and Territorial limits

3: LIMITS OF LIABILITY ON INSURANCE POLICIES

Selecting an adequate Limit of Liability in respect of Public Liability and Professional Indemnity Insurance seems to cause problems and a degree of anxiety between the Principal (TMF Agency) and Service Providers. In a lot of cases, Principals try to impose a minimum amount which Service Providers find unreasonable, too expensive to obtain or is simply not available to them. There are several reasons why this can be such a problem. There is no accepted formula to calculate an amount which will provide a guarantee that it will be adequate in all cases.

The uncertainty that the value of coverage chosen could be incorrect. What are the repercussions of what could happen if it is found to be inadequate?

Lack of understanding by Principals and Service Providers about Public Liability and Professional Indemnity insurance.

The decision is made on price alone (premium). Limits should reflect losses and exposures, not the capacity or willingness to pay premiums.

Human nature in that “It will not happen to me”.

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3 Insurance for Government Construction Project Guidelines. NSW Dept. of Commerce, Oct 2004
4: UNDERSTANDING THE IMPACT OF SELECTING A LOW LIMIT OF LIABILITY

Selecting a Limit of Liability to suit a particular level of premium is ‘bad’ economy.

This could be an unwise gamble between a short –term gain as against serious financial consequences emanating from future litigation (sometimes insurance is vital in paying legal costs to defend a suit). Premiums increase but exposures remain. The main criteria, is the need to protect the organisation.

GIO as a Claims Manager for the TMF, has for several years recommended $ 20 million as the minimum cover. From the NSW Government’s stand point, a minimum represents a benchmark. It was never intended to be inflexible although we would expect that most Service Providers would comply because the amount is not deemed unreasonable.

As already emphasised, if the only driver to go below $ 20 million is to save some dollars, we do not believe this to be acceptable.

It is up to the Service Provider to convince an Agency why $ 20 million is too high by commenting on their losses, exposures and risk management practices.

From a TMF Agency’s point of view, it is important to demonstrate that some diligence took place in agreeing to a Limit of Liability.

At the end of the day, it is a TMF Agency’s prerogative to make a business decision to accept a figure which is less than the recommended value. There may be other factors that come into play in the overall decision making. TMF Claims providers are not in the position to dictate terms to a member Agency. If due care is taken in selecting a Limit of Liability and by some combination of circumstances, the Limit proves to be inadequate in future, then the TMF would respond.

A contract officer would need to exercise care, diligence and skill of a reasonably prudent person acting in the best interest of the State. Officers must be guided by a Business Judgement Rule, akin to the duty of directors.

5: RISK MANAGEMENT APPROACH

As part of an Agency’s development of an appropriate risk management strategy for a project, an assessment needs to be made of the nature and extent of the risks involved, including those with using Service Providers. Project risks shall be defined in accordance with the provisions contained within ISO 31000. Decisions then need to be made about those risks that are to be borne by the Agency and those that are most appropriately transferred to the Service Provider.

5.1 Establish the risks that should be covered by insurance

Having identified the risks and the risk levels with the project, Agencies should next determine which risks should be insured against and the party best able to arrange the insurance.

Insurable and other risks can be categorised as follows:
• Those that are to be covered by insurance required by legislation, such as Worker’s Compensation insurance that is to be taken out by the Agency and Service Providers to cover their employees:

• Risks to all parties where the main Service Provider should be required to take out insurance to cover the Agency and all other consultants or contractors for property damage and personal injury costs arising from claims;

• Risks that are transferred to Service Providers through indemnity clauses under the contract, which the Service Provider may in turn insure against, where insurance is available and they are insurable considering market conditions.

Standards Australia Handbook 141-2004 Risk financing guidelines also provide guidance with decisions regarding risk.4

5.2 Suggested Liability Coverage Model

The following table suggests a range of Public Liability coverage. Where there is a high likelihood of personal injury, preference is to be given to applying the upper limit options of the insurance range for public liability. Insurance levels below the minimum should only be considered in exceptional circumstance, and based on sound decision making principles.

Table 1: Suggested amount of Public Liability Insurance Cover for range of Project Risk

<table>
<thead>
<tr>
<th>Project Risk Low</th>
<th>Project Risk Moderate</th>
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</thead>
<tbody>
<tr>
<td>Project Value</td>
<td>Low</td>
</tr>
<tr>
<td>$0-$5m</td>
<td>$5m</td>
</tr>
<tr>
<td>$5-$10m</td>
<td>$10m</td>
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<tr>
<td>$10-$20m</td>
<td>$20m</td>
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<tr>
<td>$20 -$50m</td>
<td>$20m</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Project Risk High</th>
<th>Project Risk Extreme</th>
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<tbody>
<tr>
<td>Project Value</td>
<td>High</td>
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<tr>
<td>$0-$5m</td>
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<tr>
<td>$20 -$50m</td>
<td>$50m</td>
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</tbody>
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6: WHO NEEDS PROFESSIONAL INDEMNITY INSURANCE?

Professional Indemnity (PI) insurance is normally required by any Service Provider who essentially provides advice, expertise on which another party is dependent. Examples are: Environmental Impact Studies, Design software, training services, project management, auditing services, etc.

6.1 Professional Indemnity Insurance

Professional Indemnity (PI) insurance covers these Service Providers, and claims against them arising out of the professional services they provide.

In basic terms Professional Indemnity covers the insured’s legal liability with any claim for compensation made against the insured for breach of professional duty in the conduct of the business practice carried on by or on behalf of the insured.

Typically Professional Indemnity cover includes, and claims may arise from the services involved where they include:-

- A breach of professional duty;
- Negligence;
- Bodily injury and property damage arising from service negligence;
- Fraud/dishonesty other than a company director’s dishonesty;
- Infringement of intellectual property; breach of duty/confidentiality;
- Defamation; and
- Loss of documentation.

Legal costs and investigation costs associated with defending an action are normally covered by Professional Indemnity.  

6.2 Policy Terms

A Professional Indemnity Insurance Policy is what is called a ‘claims made’ policy, which means that, generally speaking, it covers claims made or deemed to be made during the currency of the policy. The claims can relate to circumstances or events that occurred during or before the period of currency of the policy. However, some policies may limit the retroactive operation of the policy.

A claims made policy is to be contrasted with an event occurrence policy such as a Public Liability policy that covers claims no matter when they are made in respect of events that occur during the currency of the policy.  

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6 Professional Indemnity insurance Guidelines, Aust. Procurement and Construction Council Inc.
Professional Indemnity Insurance is usually purchased as an annually renewable policy covering the consultant’s operations as a whole as distinct from a specific project.

The guidelines below on excess, duration, exclusions etc. apply to normal annually renewable policies.

Single project professional Indemnity Insurance is available in limited circumstances and needs to be negotiated individually in all aspects including excess, duration, exclusions etc.

6.3 Excess

It is usual that the maximum excess for Professional Indemnity be stated as the higher of $50,000 or 2% of the consultant’s gross fee turnover.

6.4 Duration of Cover

Because Professional Indemnity Insurance is purchased as an Annual Policy, renewal has never been guaranteed. It is suggested that all NSW Government contracts nominate a period following completion of the services under the contract as the default period for which consultants contract to maintain the specified level of Professional Indemnity Insurance for any engagement, for as long as that insurance is available to consultants in the market on reasonable terms. These terms are to take account of the future market for insurance including factors such as the cost and availability of insurance for certain services.

6.5 Cover and Exclusions

An acceptable Professional Indemnity Policy must indemnify the Service Provider against any liability for breach of professional duty and provide general cover for liability arising out of the conduct of the professional business under the Commonwealth Trade Practices Act and the relevant State or Territory Fair Trading Acts. The scope of the cover should include property damage, economic loss and death or bodily injury arising out of the conduct of the professional business.

In relation to exclusions ensure that the Professional Indemnity Insurance policy does not contain any exclusions that are detrimental to the Agency, such as

1. Exclusions of any substantial category of work that is likely to be required under the contract, or
2. Exclusion of work performed by subcontractors or consultants engaged by the contractor.7

6.6 Evidence of Professional Indemnity Insurance

Acceptable evidence of professional Indemnity Insurance is a current Certificate of Currency presented by the consultant as issued by an underwriter or insurance broker.

The Certificate of Currency shall specify:

1) Name of Insured
2) Policy Number
3) Expiry Date
4) Name of the insurer
5) Level of Cover in the aggregate
6) Policy Excess
7) Summary of the cover provided
8) Jurisdictional and Territorial limits

6.7 Level of Cover

Two approaches are presented to indicate the suggested level of cover:

A Simplified Method and a Risk Assessment Based Method.

---

7 Professional Indemnity insurance Guidelines, Aust. Procurement and Construction Council Inc.
6.7.1 Simplified Method

This method is considered appropriate for projects that Agencies consider as conventional non-construction consultancies and for all conventional projects, (for example, all projects up to $1 million) undertaken in the civil engineering and building industries.

It is suggested that the amount of professional indemnity Insurance per event and in the aggregate, to be provided for typical projects by the consultant to the Agency should be the greater of $1 million or 10 times the fee.

6.7.2 Risk Assessment Based Model

This approach addresses particular risks associated with both the project type and the nature of the professional services being provided. Project risks shall be defined in accordance with provisions contained within ISO 31000. Each Agency will have a different view on the nature of risk associated with projects. As well, Agencies are also exposed to risks associated with the service provided by consultants.8

Table 2: Suggested amount of Professional Indemnity Insurance Cover for range of Project Risks and Service Risks:9

<table>
<thead>
<tr>
<th>Project Risk Low</th>
<th>Project Risk Moderate</th>
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</thead>
<tbody>
<tr>
<td><strong>Project Value</strong></td>
<td><strong>Service Risk</strong></td>
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<td>L</td>
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<td>$0-$5m</td>
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<td>$10-$50m</td>
<td>$2m</td>
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<tr>
<td>Over $50m</td>
<td>$5m</td>
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<table>
<thead>
<tr>
<th>Project Risk High</th>
<th>Project Risk Extreme</th>
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</thead>
<tbody>
<tr>
<td><strong>Project Value</strong></td>
<td><strong>Service Risk</strong></td>
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<td>L</td>
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<td>--------------------------------------</td>
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<td>$10-$50m</td>
<td>$5m</td>
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<tr>
<td>Over $50m</td>
<td>$10m</td>
</tr>
</tbody>
</table>

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8 Professional Indemnity insurance Guidelines, Aust. Procurement and Construction Council Inc.
9 Addendum B. Professional Indemnity Insurance Guidelines for the Building and Construction Industry
10 L= Low; M= Moderate; H= High; E= Extreme
11 L= Low; M= Moderate; H= High; E= Extreme
7.0 References

Treasury Managed Fund Scheme Structure including the Contract of Coverage, May 2008.

THE IMPORTANT (BUT LIMITED) ROLE OF INSURANCES AND INDEMNITIES

As a general rule, the contract party with the greatest ability to manage a risk should take responsibility for that risk. Arrange indemnities, disclaimers, insurances and guarantees to reflect this concept. While insurance is an essential contract condition, you should emphasise prevention rather than dealing with the consequences of loss. Besides, insurances may not adequately transfer legal and operational risks to the contractor.

Your Agency’s main focus should be reducing the number and severity of insurance claims. Create processes and competencies that minimise risk in the first instance.

Relying too heavily on insurance could result in:

- Inadequate cover and compensation for risks and losses. Also, the costs and conditions of some insurance are prohibitive. Quite often there are non-financial losses, or financial losses that are difficult to measure and claim.
- Inadequate cover for incidents caused by your Agency or a third party. Your Agency as principal or owner/occupier cannot be protected from common law duty of care or statutory duties (e.g. OH&S and Environmental legislation). Statute and common law trends are moving towards a non-delegable duty of care and contributory liability on the principal as owner/occupier or manager. Therefore, your Agency should direct and supervise contractors.
- Limited indemnity value because a contractor cannot meet a claim’s financial cost. It may be more practical for your Agency to assume and at least co-manage certain risks, especially with small to medium size contractors whose financial capacity may be disproportionate to risk levels.
- An uninsured contractor, since their policy may have lapsed without your knowledge. Smaller contractors may not be able to obtain insurance for large limits or for low deductibles (the excess). Your Agency should have its own insurance as there are serious risks in relying on a contractor’s insurance.
- Limited insurance cover because some skilled contractors are impacted by legislative initiatives to reduce professional liability. This is particularly important where the major contract risk consequences involve economic loss.
- Agencies may need to make a business decision in accepting or rejecting some risks that the contractor would assume. This is more likely where the contractor’s bargaining position is strong, for example, when there are only one or two potential candidates.
EXCESSIVE INSURANCE AND INDEMNITY COSTS

Trying to insure against all eventualities may mean increased insurance costs or unmanageable conditions. A contractor’s response to excessive indemnity and insurance costs may adversely impact your Agency. Therefore your Agency should not rely too heavily on insurance. Contractors may respond to excessive costs by:

- Attempting to transfer the calculated risk premium into the contract price (i.e. a certain cost to your Agency)
- Seeking compensation by pushing for unreasonable claims and variations on the principal during contract operations, and
- Sending a signal to potentially superior contractors that it may not be worthwhile for them to apply to your tender, especially when price predominates over the value of hiring superior contractors.

Contractors may argue for increased deductibles (excess) or lowered guarantees, bonds and insurance limits. Their argument could be based on demonstrated superior work practices and methods that already exist at their expense. In comparison, other contractors may not have any additional risk mitigation measures.

Despite the strength or legitimacy of all these defences, establishing liability and recovering damages can be extremely time-consuming. Often these additional costs are not included in any compensation your Agency may receive.

For more information go to:-
Chapter 4: Contracting Risk Management
Appendix 8: Example contractor safety process: OHS&R
Appendix 9: Sample contracting risks

1.6 APPLYING A QUALITY AND IMPROVEMENT PROCESS

Your Agency should implement management processes that ensure:

- The contract will meet your Agency’s performance requirements and expected outcomes, and
- Continuous improvement by implementing a quality assurance process during the contracting process and in subsequent contacting activities.

Any contract that your Agency drafts should include:

- Clear, measurable and relevant performance indicators
- Processes for maintaining and improving contractor competency (particularly for term contracts)
- Mechanisms to monitor and enforce contract management activities, e.g. reporting
- Incentive (or partnering) arrangements to encourage improved outcomes, and
Evidence of your Agency’s quality management framework to streamline the contracting process.

Your Agency’s quality assurance and improvement system should include statements of:

- Organisational capability
- Organisational quality
- Contract performance, and
- Commitment to public policy and stakeholder interests.

To implement and measure quality assurance, your Agency should introduce an appropriate mix of auditing and assurance processes. This process should expand to also involve the contractor and third party independent accredited experts.

**For more information go to:-**

*Chapter 5: Assurance and improvement*
Chapter 2: Deciding to contract

In this section...

Chapter 2 provides a methodology to assist your Agency in determining whether they should enter into agreements. Agreements could include arrangements, understandings or enforceable contracts with other entities. Agreements may include procuring goods and services or entering into arrangements such as joint ventures and alliances.

This section applies to both senior management and those advising executive management. Review this section carefully, especially when your Agency has committed a large amount of funds from your budget programs or the proposed undertaking has a high degree of risk attached.

2.1 STRATEGIC AND OPERATIONAL CONTEXT

Senior management has an over-arching role to ensure that agreements, whether formal or otherwise, continue to add value to your Agency, and meet legal commitments and policy directives.

In terms of dollar value, most agreements are formal contracts for construction or purchasing product, equipment or services. Funds allocated to all sources of contracting activity can approach or exceed salaries and wages. Contracting activities can extend beyond supporting core activities to actually undertaking them.

The need to procure is an obvious and often recurring necessity in most Agencies. However, as internal and external circumstances change, needs may also change. Your Agency should review procurement objectives and strategies and implement performance indicators that measure a particular strategy’s effectiveness. Your Agency should implement and review a contracting management system as part of your overall management strategy.

2.2 RISK CONTEXT

Contracting creates two fundamental risks:

- Performance risk: when expected outcomes fail to materialise, and
2.3 ACCOUNTABILITY

Given that accountability is not diminished by contracting-out services, Agencies have no alternative but to ensure that both themselves and contractors have systems and processes in place to manage contracting risks.

In general, contractors are given the responsibility of doing something according to the requirements of the contract and the law. Nevertheless Agency accountability derives from the requirement to justify their decisions in relation to the need for the contract work, the contract terms and the choice of contractor. In effect, almost anything that could go wrong in the contracting process could mean that the Agency is accountable.

The Commonwealth Government’s Industry Commission view is as follows:

‘... while the responsibility to do certain things can be transferred, accountability for the results cannot. Whatever the method of service delivery, a Government Agency must remain accountable for the efficient performance of the functions delegated to it by Government ...’

The Audit Office of NSW has endorsed this view.

Of course, not all responsibilities can be transferred. Agencies can be fully or partly responsible for the actions of contractors. Agency responsibility might arise from negligence (whether by an action, omission, statements or instruction), or in some cases by strict liability where liability cannot be delegated. The Agency use of probity auditors does not obviate accountability for making adequate decisions in the contracting process.

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2.4 CREATING A CONTRACTING MANAGEMENT SYSTEM

Senior management should have a management system for contracting. The decision to contract is part of that system. Consequently, a contracting system must exist before you decide to contract. In addition, senior management should ensure that the contracting system forms part of, and is integrated with, an overall management system. The total system may include the following sections, which are discussed in more detail later.

DETERMINE THE POLICY AND STATUTORY FRAMEWORK

In particular, managers must identify and apply relevant NSW Government policies, codes of practice, guidelines and laws. This includes general laws and regulations, and any specific to the Agency or Agency type (for example, a State-owned corporation). An example is the Public Sector Management Act (1988) and accompanying Regulation.

To assist, an extensive list is provided in Appendix1: Assistance and resources.

ESTABLISH A COMPLIANCE PROCESS FOR LEGISLATIVE AND COMMON LAW REQUIREMENTS

A guide would be to adopt the Australian Standard on Compliance Programs (AS3806: 1998) or use a Quality Assurance system.

FORMULATE A BUSINESS CASE

This is designed to ensure that proposed and expected contracting outcomes are consistent with Agency objectives. More specifically, it should show how proposed (and existing) agreements support the current corporate and strategic plans, including:

- The Agency’s direction
- Goals (or targets) set along that direction
- Effective strategies to achieve those objectives
- Establishing positive and negative performance indicators, and
- Reporting performance outcomes against objectives.

Ensure that there is requirement to define a full and appropriate contracting process at the conceptual stage. This would include stages and steps suitable for the particular contracting activity. (See Chapter 3: The contracting framework for more information.)

ENSURE THE PROCESS IS APPROPRIATELY RESOURCED

Includes being supported by the current and ongoing budget. Resources might include:

- Developing appropriate skilled and experienced personnel
- Hardware and facilities
- Work methods
- Establishing written authorisations
- Clear roles, and/or
- Reporting functions.

In many cases resources will be required when the contract is complete, for example internal training to use the completed asset or facility.
Include contracting as part of a general management system framework to apply across the Agency to include Quality Assurance, Risk Management and audit processes. Examples of structured management systems include:

- Australian Quality Council’s *Australian Business Excellence Framework* 2001, or

**For more information go to:**


Major capital asset activities: *Risk Management: Guidelines* (DPWS)

### 2.5 DETERMINING POLICY AND STATUTORY FRAMEWORK

The decision-making process for contracting needs to be made within the scope of existing external laws, policies, and codes of practice and any internal Agency policy requirements. Making decisions without knowledge and compliance of this framework is a risk that needs to be managed.

**A detailed list of Policies, codes of practice and some legislative requirements are found in Appendix 1.**

Some important policies include:


Some key documents on this website cover issues such as:

- Procurement: codes of practice and tendering
- Construction: codes of practice and tendering
- Probity auditors: criteria to determine their engagement, and
- Disclosure and confidentiality of contract information.

General legislation and regulations that require designated Agencies to utilise the services of the State Contracts Control Board (SCCB). The SCCB delegates authority to specified Agencies and according to contract value for general purchasing. Examples:

- *Public Sector Management Act 1988* and its related *Public Sector Management (Goods and Services) Regulation 2000* [particularly Schedule 1], which specifies who must, and can use period contracts and what exclusions apply, see: [www.austlii.edu.au/au/legis/nsw/consol](http://www.austlii.edu.au/au/legis/nsw/consol)

- For non-construction contracts up to $100,000, click on the hyperlink *General Purchasing Delegation*, located at: [www.supply.dpws.nsw.gov.au/NSW+Supply/Procurement+Policy](http://www.supply.dpws.nsw.gov.au/NSW+Supply/Procurement+Policy)

Using the services of the Department of Services, Technology & Administration Public Works Division might not mean that Agencies are limited to common use period contracts if there are special requirements.
• Any specific governing legislation applicable only to your Agency or as part of an Agency type.
• Identify internal Agency policies that might apply to units, areas or services within the Agency.

For example: the Department of Health is not listed on Schedule 1 of the Act, but has an internal policy that requires Area Health Services to use period contracts provided by the Supply Unit of the Department of Services, Technology & Administration Public Works Division.

2.6 APPROVE THE CONTRACTING PROCESS

A contracting process forms an important part of a contracting management system. Management needs to authorise the process even if other staff or external advisors recommend that process. An example is a three-phase and eleven-step process.

For more information go to:-

Chapter 3: The contracting framework

Shown as follows:

<table>
<thead>
<tr>
<th>Phase</th>
<th>Step</th>
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</thead>
<tbody>
<tr>
<td>1 Contract planning</td>
<td>1. Identify the need to contract and extent of risk assessment required</td>
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<tr>
<td></td>
<td>2. Plan the contract process and set criteria</td>
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<td>3. Develop the type of contract, conditions and specifications</td>
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<td></td>
<td>4. Invite and receive offers</td>
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<td></td>
<td>5. Evaluate offers</td>
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<td>6. Negotiate and apply due diligence</td>
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<td></td>
<td>7. Finalise and award the contract</td>
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<td></td>
<td>8. Manage the transition</td>
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<td></td>
<td>9. Manage the operation</td>
</tr>
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<td></td>
<td>10. Evaluate performance</td>
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<td></td>
<td>11. Review contract options (complete, extend, renew)</td>
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</table>

Note: Each step must involve a monitoring, consultation and feedback process.

In order to determine that the proposed contract is compatible with the corporate and strategic plans, senior management will need to be actively involved at the first step: Identify the need to contract and extent of risk assessment.
In addition, senior management are likely to be directly involved in Step 7, Finalise and award the contract. Of course, a contract monitoring process will keep management abreast of the progress at each step.

2.7 DEVELOPING A BUSINESS CASE

The Business Case forms the foundation for the contracting planning process and is highly recommended for all projects that are high value, complex or strategic. It involves a rigorous assessment of a proposal in terms of all the costs, benefits, risks and options and provides an Agency with a checklist to:

- Ensure the initiative is feasible
- Identify the preferred strategy and pathway, and
- Confirm that the option chosen will meet the objectives set.

This process imposes a discipline on decision makers and requires them to consider all available options, to recognise the baseline costs and to address all the issues and risks involved in making the right decision. The Business Case should show expected cash flows and include the rationale for quantifying benefits and costs. It should also identify benchmarks and critical success factors to assess each option, along with a formal analysis of all significant risks.

The Business Case should address the risks associated with each option and ensure that:

- Risks are identified in terms of likelihood and impact
- The consequence of adverse contractual performance is considered, and
- Strategies are developed to manage risks and potential consequences.

POSSIBLE APPROACH: FATAL FLAW ANALYSIS

This analysis is designed to identify potential major risks during all stages of the contracting process. The aim is to identify only major threats to the contract’s viability. This allows management to ascertain if the risks can be reduced to an acceptable level or prevent the process from continuing. There are three stages to conducting the analysis:

1. Ensure the contract’s purpose and expected outcomes align with core values
2. Determine all high-level risks that have catastrophic or high consequences, ascertain if improved controls can reduce the likelihood or severity so the risk level is lowered, or whether management is prepared to retain high-level risks
3. Make a case either to continue the process or abandon it if essential criteria cannot be met or key risks cannot be managed adequately or cost effectively. For example, contracting may not be appropriate when outcomes cannot adequately be measured or when there is a lack of quality and/or financially viable contractors.

For more information go to:-

Appendix 2: Identify and assess risks
2.8 EXAMPLES OF HIGH-LEVEL CONTRACTING RISKS

Senior management need to identify and evaluate risks that could have a large, long-term, or irreversible adverse impact in meeting key objectives and operational performance.

Senior management should consider two sources of high-level or strategic risks:

1. Whether or not you should enter into an agreement, and
2. When the decision about the contract type, term or structure fails to meet organisational objectives.

Example scenarios include:

- Failing to integrate outsourced activities into total operations
- Severe loss of corporate history (Agency knowledge)
- Major industrial disputes from outsourcing strategy
- Where a critical part of the Agency operation fails because of the failure of one contractor (business continuity)
- Where achieving contractual performance does not achieve expected operational performance. (Typically this arises either because of an inadequate scope or the nature of the activity is not easily measured by objective performance indicators)
- Excessively assuming contractor’s risks (legal or commercial)
- Avoidable major cost blow-out (or fall in income) against budget
- Losses arising from a failure to contract, for example, a void contract or unenforceable agreement that limits remedies if the contractor fails to perform, and
- Non-sustainable working capital strategy, for example, applying income sourced from contracted sales of non-recurring fixed assets to fund recurrent short-term expenditure.

For more information go to:-

Chapter 4: Contracting Risk Management

For Department of Services, Technology & Administration Public Works Division assistance see Appendix 1.

For one-off contracts, contact Procurement Solutions

For construction contracts, contact the Project Management Group
Chapter 3: The contracting framework

In this section...

Contracting definitions
Role of SCCB & Department of Services, Technology & Administration Public Works Division
Success factors in contracting
The contracting process

Chapter 3 defines and describes the contracting process. It details the roles of the State Contracts Control Board (SCCB) and the Department of Services, Technology & Administration Public Works Division and outlines the key factors required to make a major contracting process successful.

This section is useful for anyone managing the contracting process and those new to contracting.

3.1 SCOPE

Not all agreements are contracts - some are not legally-enforceable. Agencies need to manage all agreements of which contracts are the major and most common type. There are two reasons for including a wider scope:

3. Agreements that are unenforceable – such as arrangements and understandings can involve significant resources and risks, and

4. For some legislation, such as the Trade Practices Act 1974 (Commonwealth) and Fair Trading Act (NSW), the law extends to agreements outside of legally-binding contracts.

Examples of non-contract agreements are agreements between two non-incorporated Government Agencies, or a memorandum of understanding between an Agency and a private community service. In the first case there is no contract because Agencies are a single entity and hence cannot contract with themselves. In the second case, there was no intention to create legal relations. In both cases, however, this does not mean that performance of the agreement is any less important.

While contracts and contracting will dominate the discussion, managers should oversee all agreements and the processes leading to their establishment, monitoring and evaluation.

3.2 CONTRACTING DEFINITIONS

Contracts are subject to the terms of an agreement and the principles of common law. The validity and effectiveness of contracts can also be subject to statute law, for example, the Trade Practices Act 1974 (Commonwealth) and Fair Trading Act 1987 (NSW). In some cases, contracts themselves can be subject to a specific Act, such as for some major infrastructure projects.

Contracts can be simple written agreements, verbal agreements or complex legal documents. Actions undertaken by Agencies can create a contract where it was not intended, for example, creating an employment relationship with subcontractors or retaining extensive liabilities not wanted or intended due to the contract’s nature and the way in which it was created and written.
The terms contract and contracting are not the same. A contract has an identifiable start and completion date according to legal rules. Contracting has a much wider timeframe and number of activities. Contracting is a process that should commence well before a contract or agreement is established, and concluded after the formal contract is complete.

Once an Agency has made a decision to proceed towards a contract, it is essential to determine its type and attendant risks. This section identifies the contracting process and Chapter 4: Contracting Risk Management addresses the risk factors associated.

There are many forms of agreements found in the public sector. Ten examples are described below:

1. **Outsourcing**: engaging other providers to undertake activities required of the Agency. Common examples of outsourced functions are cleaning, information technology, security services and various types of waste disposal.

2. **Procurement**: buying-in things such as specialist services, products or equipment. Common examples include property management, capital works, office equipment and plant.

3. **In-house agreements**: agreements made within an Agency. Common examples are competitive tendering and service level agreements. (Note: unlike the other activities this one is not legally enforceable, as you cannot contract with yourself)

4. **Privatisation**: the sale or partial sale of Government departments or assets to the private sector.

5. **Sales and disposals of products or services**: common examples are sale of Government land and buildings, licences and publications.

6. **Joint ventures**: examples include service agreements between public and private sector services (e.g. welfare) and agreements between separate Government Agencies.

7. **Consent agreements**: for example consent to undergo medical procedures.

8. **Leases**: provide a defined form of interest that a lessee has in a lessor’s property.

9. **Licenses**: provide authority for another entity to use, occupy or allow an undertaking in a limited and non-transferable way.

10. **Barter**: exchanging some form of non-monetary assets, for example receiving an ongoing service for providing a fixed asset between Government Agencies.

### 3.3 THE ROLE OF THE SCCB AND DEPARTMENT OF SERVICES, TECHNOLOGY & ADMINISTRATION PUBLIC WORKS DIVISION

Before entering into contracts, Agencies need to understand any obligations and available options for engaging the services provided by the State Contracts Control Board (SCCB) and Department of Services, Technology & Administration Public Works Division.

Basically, your Agency needs to consider two important factors:
1. Ascertain any legislative or policy prescriptions that require the use of the services, policies and guidelines issued by of the Department of Services, Technology & Administration Public Works Division for contracting activities, and

2. Actively use the consultative process offered by the Department of Services, Technology & Administration Public Works Division ensuring that Agency contracting requirements are appropriately identified, assessed and monitored.

The Board is an Agency of the Crown. It provides a formal structure in NSW for user participation in public sector contracting. It is responsible for developing and implementing the whole of Government purchasing policy and for the conduct of purchasing, supply and disposal functions. Contracting in almost all Agencies comes under the direct or delegated control of the Board.

The Minister for Commerce might direct the Board in the exercise of its functions. Its role, as well as the extent to which individual Agency’s are allowed to operate independently of the Board’s tender and quotation system, is set out in the Public Sector Management (Goods and Services) Regulation 2000. For example, the NSW Police Force is an exception but it can choose to use the Board’s services.

The Director-General of the Department of Services, Technology & Administration Public Works Division (or an appointed deputy) chairs the Board. The department comes under the direction of the Minister for Commerce and the Director-General.

The Department of Services, Technology & Administration Public Works Division conducts three major activities:

1. **Developing and implementing the whole of Government policies.** Key areas include procurement, asset management and office accommodation
2. **Providing strategic advice.** Examples include contracting, Risk Management, property acquisitions and disposals, and
3. **Delivering professional and business services.** Examples include project management, architecture, engineering, property and facilities management, fleet management, printing, mail and information management.

Department of Services, Technology & Administration Public Works Division undertakes contracting projects on behalf of Agencies, as the principal or project manager, or in an advisory capacity and has a major role in developing and managing contracts for large construction projects.

NSW Supply is a unit of Department of Services, Technology & Administration Public Works Division. Its role is to arrange and administer contracts for the supply of goods and services in accordance with State Government policy and Board guidelines. Their key role is to arrange and administer a wide range of standing offers (sometimes known as period or common-use contracts) for goods and services from numerous pre-selected providers. The standing offers become contracts upon acceptance by the purchasing Agency. In addition, the unit arranges one-off contracts for the supply, service and renewal of contracts.

**For more information go to:-**

**Appendix 1: Assistance and resources – current documents that your Agency should consider.**
3.4 GENERAL SUCCESS FACTORS IN CONTRACTING

Before describing the contracting process, it might be useful to keep in mind the key factors that a major contracting process requires for success. Certain factors need to exist and remain relevant at all stages of the process. The first three critical success factors could be considered as strategic while the remaining factors could be considered tactical.

For more information go to:-

Pinto and Slevin model [1987]. Cited in Project Management: A Managerial Approach, by Meredith and Mantel 13

<table>
<thead>
<tr>
<th>Critical Success Factor</th>
<th>Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Project mission</td>
<td>Clarify goals and direction</td>
</tr>
<tr>
<td>Senior management support</td>
<td>Provide resources and authority</td>
</tr>
<tr>
<td>Project schedule/plans</td>
<td>Specify steps required for implementation</td>
</tr>
<tr>
<td>Consultation</td>
<td>Continuously communicate between your Agency and contractor, and contractor with their subcontractors</td>
</tr>
<tr>
<td>Appropriate personnel</td>
<td>Recruit, select and train competent personnel</td>
</tr>
<tr>
<td>Technical expertise</td>
<td>Choose appropriate options, obtain available resources and source expertise to apply your options</td>
</tr>
<tr>
<td>Continuous agreement</td>
<td>Agree at all steps before the next step in the process</td>
</tr>
<tr>
<td>Monitoring and feedback</td>
<td>Measure and report contract performance against your Agency’s criteria, budget and timescales</td>
</tr>
<tr>
<td>Troubleshooting</td>
<td>Prepare early-response and preparedness plans for unexpected crises or deviations from the project plan</td>
</tr>
<tr>
<td>Continuous communication</td>
<td>Communicate clearly throughout each of the above factors to designated personnel verbally, through writing or using data</td>
</tr>
</tbody>
</table>

DETERMINING THE EXTENT OF AGENCY INVOLVEMENT

A critical decision is determining the extent of your Agency’s involvement when managing contractor activities. Make the decision before forming the contract so that the nature of your involvement forms part of the contract conditions.

Your Agency’s involvement could range from being re-active (responding to specific problems) to full supervision and instruction. It is rare for either of these extremes to be the best option.

Your Agency’s level of involvement is likely to derive from your assessment of key risks matched against the contractor’s experience and capabilities.

The example and diagram below demonstrates this principle, by calling for risk-mitigating measures on a relatively inexperienced contractor until the assessed risks are either tolerated or minimised.

Example: When considering hiring a contractor, the initial assessment finds that the contractor falls within the unacceptable level of risk after considering benefits, unfavourable outcomes, stakeholder expectations, and fundamental rules. After a mitigating measure is put in place (i.e. a good project team), the potential for adverse outcomes moves inside the tolerable risk range. Subsequently, because of possible public concerns about timely service, an arrangement to co-manage the project is put in place which reduces risk even further. If a third mitigating measure is added – in this case weekly reporting, then a minimal risk acceptance level is reached but at a greater cost. Reaching minimal risk should be avoided unless cost-justifiable.

Source: Performance Management Network Inc. (Canada) published in Optimum, the Journal for Public Sector Management, Vol. 27, No.3, (pp.14-23) 1997
MANAGING AN INEXPERIENCED CONTRACTOR

Benefits
- Cost savings
- Future-orientated technology

Unfavourable outcomes
- Disruption to Agency operations
- Cost over-runs
- Dispute with subcontractors

Assess risk
- Stakeholder analysis: public concern
- Fundamental rules:
  - Acceptable
  - Unacceptable

Risk mitigating options
- Accept/tracking
- Add measures avoid/to ‘minimal’
- Reduce measures achieved ‘tolerable’
3.5 The Contracting Process

The system for managing contract risks involves undertaking a three-stage process:

1. Formulate the appropriate contract process
2. Develop the risk assessment process ([Appendix 2: Identify and assess risks]), and then
3. Manage risks in the contract process.

The remainder of this chapter deals with the first stage, i.e., Formulate the appropriate contract process.

Successful contract outcomes are more likely to result from defining and managing activities according to a logical and structured contracting process suitable for the proposed activities. As we showed in Chapter 2, three phases and 11 steps are involved.

When a contract is complete, the above process needs to be handed over and integrated with your Agency’s operations. This new process is called post-contract management.

Phase 1: Contract Planning

Planning is the most important phase, since it identifies the seeds of contractual difficulty.

Step 1: Identify the Need to Contract

- Undertake a risk identification and assessment
- Determine what is actually required to achieve the intended contracting outcome
- Define the need in detail
- Describe why and where the need arose
- Demonstrate how the need aligns with the achievement of strategic objectives
- Determine the need’s priority compared to other needs
- Describe what would happen if the acquisition did not proceed
- Describe how satisfying the need will impact on resources, for example replacing and enhancing existing resources or considering in-house resources
- Determine all the additional roles and functions designed to support key procurement/project outcomes, for example, Agency role to undertake risk assessment in accordance with OH&S Regulation 2001
- Justify the proposed expenditure as effective use of public money, and
- For proposed contracts with complex, high value or substantial risks, a formal Business Case might be required (see next).

Developing a Business Case

See Appendix 3.

For more information go to:-
STEP 2: PLAN THE PURCHASE PROCESS AND ESTABLISH CRITERIA
See Appendix 4: Plan the purchase for details.

STEP 3: DEVELOP PROPOSED CONTRACT, CONDITIONS AND SPECIFICATIONS
(Where a tender is required, refer NSW Government Codes of Tendering and Implementation Guidelines by Department of Services, Technology & Administration Public Works Division).

Determine:

- Conditions of tendering, and
- Conditions of contract.

Conditions are terms that are vital to a contract and can affect all or part of the contract. A breach could lead to damages or termination. Numerous conditions can exist and depend upon your Agency’s needs and intentions. They are likely to include indemnities, insurances, defect period, minimum performance criteria and so on.

Determine if there is a need to take additional control in the process by separating contract conditions that must be met before, or after establishing the contract:

- \textit{Conditions precedent}: obligations required before contract formation. Example conditions: insurance requirements; evidence of a licence or permit authorising the contractor to undertake the activity, or
- \textit{Conditions subsequent}: obligations required after contract formation but before a defined time or occurrence. Example condition: Independent sign-off by Agency project manager before commencement of next stage of works, and
- Warranties of contract.

Terms that are required but are not essential to continuation of the contract:

- Statement of requirements/specification (a vital activity) - detailed descriptions of requirements of equipment, service or construction including dimensions scope materials etc.
- Vendor response schedules
- Contract type, including fixed price, variable contracts, schedule of rates, cost-reimbursable contracts, cost-incentive contracts, performance-incentive contracts, partnering and alliances, and combinations of the above
- \textit{Standing offer}, i.e., Agency option to contract upon pre-agreed terms, and
- Legal team consultation, advice, recommendation and sign-off.

PHASE 2: CONTRACT FORMATION
Phase 2 requires considerable emphasis on probity and procedural fairness.

STEP 4: INVITE AND RECEIVE OFFERS
See Appendix 6: Invite and receive offers.
STEP 5: EVALUATE OFFERS

- Assess compliance to set criteria
- Score the non-cost selection criteria
- Analyse cost. This includes actual costs, adjustments for policy requirements for example, Government preference schemes and consideration of the relative impact of all costs over the lifecycle.

For example the quality, durability and effectiveness of what is offered by one tender applicant might exceed minimum requirements and more than compensate for the higher offer price in their tender. To assess the true value, Agencies need to consider ‘whole of life’ costs. This includes the contract price, reasonable variations/contingencies, expected repairs and maintenance, training, and so on. Obtain the net impact by adding income from expected disposal and any income earning assets. Cost on a net present-value basis for high cost (say over $2 million) and long-term assets

- Consider low-priced offers in greater depth. Check closely for effectiveness, history of operational performance and any excessive propensity to seek variations; this is a vital activity
- Score cost – choose either cost-range scoring, or average-based scoring
- Assess wider economic and community benefits, for example: Government Guidelines – Economic Development
- Determine whether presentations are required, and
- The value-for-money decision.

Methodologies to undertake value for money analysis:

- Comparing capability with cost
- Comparing affordability with cost
- Assessment
- More detailed assessments
- Value-for-money index, and
- Consider broader value-for-money issues.

STEP 6: NEGOTIATE AND APPLY DUE DILIGENCE

- Determine the Negotiation team
- Negotiation strategy
- Formal due diligence, and
- The recommendation report.
STEP 7: FINALISE AND AWARD THE CONTRACT

- Award contract via authorised process
- Inform unsuccessful tenderers in standard format and brief where requested
- Maintain an audit trail, and
- Review and disclose.

For contracts in excess of $100,000, make certain contract information is made public according to NSW Guidelines for the Disclosure of Information within 90 days of awarding the contract.

For more information go to:

PHASE 3: CONTRACT MANAGEMENT

Phase 3 is largely performance of the contract by the contractor. The Agency needs to concentrate on monitoring, reviewing and making necessary alterations to the agreed contract.

STEP 8: MANAGE THE TRANSITION (IF APPLICABLE)

Either an induction or handover process can assist in minimising disruption and risks when:

- Commencing a new service or project
- Managing a transition from an internal to an external provider, or
- Assimilating a contractor into Agency operations.

Consider:

- Risk assessment and briefing of staff/other contractors of likely impacts
- Contractor induction to include Agency values, key objectives and strategies
- Establishment of clear and regular lines of communication, including feedback, monitoring, and early-warning notification of actual or potential problems
- Funding limited parallel operations between outgoing and incoming operators
- Include training/review of any continuation of existing machinery and equipment to be used (i.e., either leased/owned by the Agency or sold/leased to the incoming contractor)
- Ensure maintenance and repair register handover (required by OHS Act), and
- Determine and evaluate obsolete/hazardous processes and equipment (for example, Hazop).
STEP 9: MANAGE THE OPERATION
This is the critical step of contract implementation. The management process will depend upon the nature of the activities. Your Agency should establish a Contract Management Plan, which assists in providing critical information on contract objectives, all the parties involved, risks, documents, schedules and so on. See Appendix 7.

For more information go to:-
DPWS: Contractor Performance Reporting and Exchange of Reports between Government Agencies – Guidelines

STEP 10: EVALUATE PERFORMANCE
If the performance monitoring and audit processes during the operation are undertaken there should be little further information and evaluation necessary at this step. The exception might be when the performance is over a very short duration or there are only one or a few steps in completing the contract.

Performance evaluation requires:

- Debrief meeting
- Completion report
- Project evaluation checklist, and
- Exchange of reports between NSW Government Agencies.

For construction and other large contracts, make the completion report available for other NSW Government Agencies – provided allowance is made in the conditions of tendering and contract.

For more information go to:-
Department of Services, Technology & Administration Public Works Division: Contractor Performance Reporting and Exchange of Reports between Government Agencies – Guidelines

STEP 11: REVIEW CONTRACT OPTIONS
Integrate the completed contract with your Agency’s asset management (repairs and maintenance), and training programs. Record and monitor post-completion defects and warranty periods (according to the contract), statutory requirements and any Professional Indemnity insurance.

If the works are of a recurring nature, then consider in accordance with Government policy guidelines, whether to:

- Extend
- Renew, or
- Undertake a new tender/quote process.

Initiate quality improvement actions Your Agency should:

- Review the initial Business Case to determine if the contract meets objectives and performance indicators, if circumstances have changed, or might change
• Prepare and submit a Recommended Process Improvement report to management, incorporating suggested changes based on the lessons learned during the entire contracting process (i.e., not just contract performance). Derive this report from the completion report, project evaluation checklist, exchange of reports between NSW Government Agencies, debriefing meetings, audit reports, and major accident/incident investigation (when they occur).

Initiate post contract management after handover. Your Agency should:

• Identify, report and monitor defects. Ensure professional indemnity insurance is current
• Establish a maintenance and repairs program
• Implement training for users of the product, service or asset
• Establish processes to manage all relevant risks such as safety, legal liability, security, environmental impact, efficiency and effectiveness – including identifying obsolescence and timely disposal, and
• Review and report on operational performance objectives according to the Business Case.
Chapter 4: Contracting Risk Management

4.1 THE CONTRACT RISK MANAGEMENT PROCESS

The Risk Management process supports decision-making in all steps of the contracting process and aims to enhance assurance that the contract has adequate specifications and terms, the right contractor is chosen and key risks are managed at all stages.

On completion, additional processes are required that could be described as *post-contract management*. This includes life-cycle analysis of the asset or service.

It is imperative that a rigorous Risk Management process is established and is integrated with all management systems in your Agency. The Australian Standard AS/NZS ISO 31000:2009 *Risk management – Principles and guidelines* is a useful reference guide.

Managing risks in the contracting process requires an understanding of two factors:

1. The Risk Management process, and
2. How Risk Management is applied to the contracting process.

These are shown in the next few pages.

For more information go to:-

### RISK MANAGEMENT PROCESS

<table>
<thead>
<tr>
<th>1. Establish the context</th>
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<tbody>
<tr>
<td>What is the strategic and organisational role of contracting?</td>
<td>To find this, establish the following:</td>
</tr>
<tr>
<td></td>
<td>• Agency objectives (direction) and goals (target)</td>
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<td>• Activities where contracting can optimise the attainment of those objectives and goals</td>
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<tr>
<td></td>
<td>• How performance will be measured, i.e., create evaluation criteria and performance indicators, and</td>
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<tr>
<td></td>
<td>• Define suitable definitions of risk levels, from low to high, according to possible risks in achieving those objectives and goals. This in turn is achieved by defining rates of likelihood and consequences.</td>
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<tr>
<td></td>
<td>See Appendix 2: for likelihood, consequence and risk level tables.</td>
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<table>
<thead>
<tr>
<th>2. Identify the risks</th>
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<tbody>
<tr>
<td>Postulate what could happen and how:</td>
<td></td>
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<tr>
<td></td>
<td>• What is the nature of the activity, the equipment and work methods required to do it? Who are the personnel undertaking it? What other persons and their property and activities could be impacted by the activity?</td>
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<tr>
<td></td>
<td>• Look at experience via reviews, claims, incidents, records and so on</td>
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<td></td>
<td>• Look at hidden threats, proposed activities and possible new circumstances</td>
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<td></td>
<td>• Appoint a facilitator to extract ‘corporate knowledge’ using team-based exercises</td>
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<tr>
<td></td>
<td>• Hire a contracting risks expert, and</td>
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<td></td>
<td>• Refer to the risks listed in section 4.2 Common causes of contracting risks</td>
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<tr>
<th>3. Analyse the risks</th>
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<tbody>
<tr>
<td>Estimate risk levels. Consider and record:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Possible causes - direct, underlying and system-based</td>
</tr>
<tr>
<td></td>
<td>• The maximum reasonable consequence level. Consider effectiveness, cost and efficiency, health and safety, liability, environment, property and reputation and image, and</td>
</tr>
<tr>
<td></td>
<td>• The likelihood of occurrence for that consequence level.</td>
</tr>
<tr>
<td></td>
<td>Determine existing controls to eliminate or reduce the likelihood and consequences, i.e., what procedures and processes exist either to provide a defence against the occurrence, or reduce the adverse impacts if the situation or event does occur?</td>
</tr>
<tr>
<td></td>
<td>Establish a preliminary list of risks from highest to lowest risk level.</td>
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</tbody>
</table>
### 4. Evaluate and prioritise risks

Determine risks that might need further treatment:
- Compare risks with the evaluation criteria set in context
- Reconsider the appropriateness of the criteria with the preliminary list of risks and risk levels
- Re-adjust risks and risk levels, paying particular attention to medium and high risks, and
- Propose which risks can be tolerated and which require more treatment to reduce the risk level.

### 5. Treat the risks

Take action to reduce risks and record what level of risk is retained:
- Identify options to eliminate or reduce and/or transfer risks
- Determine the net benefit (i.e., cost/benefit) of the options
- Recommend the preferred option
- Propose an all risks treatment plan (i.e., list all risks requiring treatment, the proposed treatment, estimated budget, those responsible, and realistic start and completion dates)
- Prepare specific implementation plans (i.e., the person responsible for each risk reviews and proposes how this will be done), and
- Ensure that treatments are aligned with the Agency management system, i.e., all its processes and procedures.

See examples in Appendix 2

**Monitoring, consultation and review** occur continuously during all the above-mentioned stages. Determining risk levels is a process of continuously reviewing the possible likelihood of an occurrence at a defined level of consequence.

For more information go to:

Appendix 2 for sample risk classifications, Risk areas and a model risk assessment

### 4.2 COMMON CAUSES OF CONTRACTING RISKS

Many of the risks during the contacting process result from three basic causes.

Focus on three activities during the early stages of the Risk Management analysis:

3. Define an adequate scope (including specification)
4. Choose an appropriate contractor (and/or subcontractors), and
5. Manage the implementation.

These activities and their management strategies are described in the rest of this chapter.
KEY CAUSE 1: INADEQUATE SCOPE AND SPECIFICATION

Always fully understand your Agency’s needs and communicate these clearly to the contractor, otherwise you’re likely to ‘get what you ask for’.

The scope is a critical part of the contract. It explains what your Agency wants from a service, product, item of equipment or a construction. The main part of the scope is the specification, which is usually an extensive and detailed description of the requirements to meet the essential deliverable/s at contract completion. To meet your Agency’s requirements the scope should:

- Cover all requirements in a well-defined manner
- Provide accuracy in important areas
- Detail practical requirements, for example, realistic performance timeframes
- Uphold consistent laws or regulations, for example, building codes
- Include an unbiased specification, for example, by excluding brand names and only made in clauses
- Ask for appropriate design, technology and effective work methods, and
- Refer to appropriate and standards and benchmarks on quality, quantity etc.

These factors are often not defined in contracts because Agency staff may lack evaluation expertise or simply lack the time to analyse these factors.

Failing to accurately define scope may cause:

- Ineffective or hazardous services, equipment or infrastructure, and
- Expensive variations and cost overruns to correct the inadequate base scope.

Your Agency should also be aware of contractors who provide low quotes based on ‘skeleton’ or incorrect specifications because they expect to receive favourable cost variations throughout the contract.

ENSURING AN APPROPRIATE SCOPE

Link contracting scope to your Agency’s strategic and specific operational objectives to ensure an appropriate contracting framework. Investigate how the contract supports your Agency’s objectives and formulate a scope based on those objectives.

Evaluate the contract in terms of its performance criteria, which should be consistent with your Agency’s objectives. A good method of evaluating scope is to establish an evaluation committee, which provides recommendations to senior management. Include a range of expert staff and/or consider outside contracted assistance such as Department of Services, Technology & Administration Public Works Division or other independent advisors.

Evaluate a contract’s scope by paying attention to its:

- Stand-alone functionality (including design, technology and required work methods in using the asset)
- Integration with your Agency’s working environment i.e., integrating with other equipment, products and activities under all conditions
- Quality assurance and improvement, paying particular attention to including industry benchmarks and standards, and
• Life-cycle considerations, according to expected usage, obsolescence and disposal value.

KEY CAUSE 2: CHOOSING AN APPROPRIATE CONTRACTOR

Once the scope is defined, the process moves towards choosing an appropriate contractor. Some key factors that impact on contractor choice include:

• Choosing an appropriate method to invite and receive offers, For example, requiring an overly complex and time consuming tender process could limit the number of interested prospects.

• Allowing reasonable time for potential invitees to respond and for contractors to perform. Not allowing sufficient time increases the likelihood of limiting the available pool of quality contractors. Risk factors include:
  • Successful contractors being are more likely to be in high demand and consequently their services might not be available at short notice
  • Contractors with less integrity might apply for a contract that requires tight time schedules knowing they will be revised and need an upward variation to cost, and
  • Contractors with limited available resources might respond by employing less experienced or ‘untested’ new employees and subcontractors. The result is an increase in the likelihood of inadequate outcomes.

More specifically, the contracting process needs to allocate sufficient time between:

• The invitation and closing date for offers
• The date the contract is awarded and the required date for practical commencement, and
• Date of practical commencement to completion date, particularly where the completion date is critical.

COST

Typically cost is a major consideration. The danger is not measuring the real cost for the expected value. There is a need not only to compare the offer prices from competing offers, but also how they might differ according to estimated life cycle costs.

Estimate life cycle costs. This involves contractor and Agency costs. A Net Present Value (NPV) costing basis is required then there are large and long-term cost impacts.
a) Payments to contractor typically include:

• Lump sum, for example, for defined service/product
• Schedule of rates, for example, when quantity of work on an ‘as required’ basis with or without a limit
• If costs are not fixed in AUD then consider ‘rise and fall’ costs of either local market prices or methods of fixing prices for imported items, and
• Ongoing maintenance costs such as repairs, training and servicing.
b) Agency internal costs:

- Physical and human resources to train/utilise/maintain/upgrade assets
- Costs of tender/quote process
- Establish a net cost after accounting for external revenue/income from disposal:
- Essential knowledge, experience and technical ability to meet the scope and specifications
- Financial capability, including net assets, cash-flow and dependency on one or a few customers or contracts
- Integrity of contractor management
- All requisite approvals such as licenses, permits and so on, to undertake the activity, and
- Factors influencing continuity of business operations. For example, are there signs that the contractor might be unavailable for renewal, or lack interest in performing above minimum requirements? Does the applicant have a contingency plan if their first source of supply fails?
- Management and communication skills of key contractor personnel, for example, project manager
- Demonstrated skills and expertise in required management systems, for example OH&S, environment, monitoring and reporting, industrial relations, quality systems (QA and Quality Improvement), preventative maintenance

Determine the need for Risk Management in key areas. For example,

- Preparedness plans including:
  - Disaster recovery, i.e., immediate and interim response necessary to continue operations
  - Business continuity, i.e., actions required to return to full operational effectiveness
  - Corporate (crisis), i.e., a plan for describing how to respond, and determining criteria for choosing the appropriate response to key stakeholders (for example, the Minister, community, and media)
  - Fraud control
  - Health and safety
  - Environment, and
  - Self-audit of all the above-mentioned.

- Quality of subcontractors preferred by the applicant, particularly specialists who are critical to the outcome, for example, design consultants. Contract should allow Agency to veto the applicant’s preferred choice of subcontractors
Adherence to both minimum, and preferred, contract terms and conditions relating to:

- Warranties and guarantees
- Indemnities
- Liquidated damages
- Insurances
- Exclusions and disclaimers
- Ownership of contractor’s intellectual property (whether brought with them or developed during the contract), and
- Acceptance on the method to cost variations, the definition and responsibility for latent conditions, force majeure, contract suspension or termination for whatever reason.

**CHOOSING AN APPROPRIATE CONTRACTOR**

The evaluation committee needs to:

- Obtain external expert opinion if internal expertise is lacking
- Establish a list of all the criteria required to maximise the likelihood of a successful outcome (as listed above)
- Undertake a risk identification and assessment to determine the major risks. This will impact decisions made in determining essential criteria and weightings applied to all criteria
- Determine what is essential and what is preferred
- Place a quantitative and/or qualitative measurement to the criteria for example, numeric estimate of their relative importance according to a defined scale, for example, total =100
- Rank applicants that meet essential criteria according to weightings. It might be useful to do this on the basis of both including, and excluding, cost as criteria. This allows low cost offers to be compared more rigorously with other offers
- Undertake a sensitivity analysis. This requires a re-examination of the results by marginally altering weights to criteria, and reconsidering the appropriateness of criteria (provided it does not vary tender conditions). This activity is particularly applicable if the top two or three applicants have close scores
- Where possible and practical, test that the product/service is appropriate before concluding the contract. Use strategies such as pilot testing, trial-offer periods, short-term leases with option to buy, obtain testimonials from other users under similar conditions and obtaining a list of the applicant’s customers during the past two years and check with selected users.

**Note:** Testimonials provided by applicants are not likely to provide objective information of historical performance.
**KEY CAUSE 3: MANAGING IMPLEMENTATION**

No matter how appropriate the initial scope and the choice of contractor, the implementation stage can offer unexpected challenges for Agencies.

Situations can arise that require a prompt and timely Agency response. Typically, these require important decisions to rectify, adjust or acknowledge a change from the original plan. Agencies need to know as soon as possible whether:

- Progress is falling short of the original plan, or
- The plan needs to be revised following a realisation that the original scope or specification will not fully satisfy key needs.

A Baseline plan must be agreed with the contractor. This usually consists of the following:

- Establishing intermediate performance indicators for contracts with longer projects, i.e., milestones
- Defining the required tasks
- Defining the *relationship between tasks* so that they are effective, efficient and safe. Define sequence, concurrence with other tasks and resources assigned each task, and
- Determine the method of invoicing costs to the Agency by linking payment terms with implementation rather than on a time basis. For example, this might include physical delivery of a completed good, milestones, resource usage, full completion and so on.

**MANAGING CONTRACT IMPLEMENTATION**

**Track the progress**

This means to manage and monitor actual performance against the Baseline plan. Typically it includes assessing and making corrective action to minimise adverse variations of cost, resource usage and task completion progress against the schedule.

You should have an effective contract progress monitoring system in place.

For contracted projects with greater levels of complexity and with resource limitations, Agencies need to require from contractors more sophisticated project management techniques. This also means that the Agency need staff, or contracted experts, trained in using appropriate tools such as:

- Gantt Chart - A bar chart showing planned and actual progress for tasks over time, and
- Where time management is critical, use the critical path method (CPM), or the program evaluation and review technique (PERT). Both techniques can be found on common software. They record tasks that are critical to completion, and tasks that have potential ‘slack’. They help determine where Risk Management effort should be focused.

Undertake a joint risk assessment with the contractor. Include a requirement for the contractor to describe and map the process of activities so they can be reviewed and audited by the Agency.

Conduct regular consultation meetings involving:
• The Agency contract (or project) manager
• The representative of the principal contractor
• Other key contractor managers (such as risk experts)
• Any key subcontractors, and
• Other key stakeholders, for example unions, public and business representative groups likely to use, or be impacted by the contract activity or expected contract outcomes, local councils, and so on.

For more information go to:
Guide to Contractor Performance Reporting in:
Chapter 5: Assurance and improvement

Chapter 5 ensures quality management from the contracting process and provides a structure for post-contract analysis and improvement.

This section outlines what’s required from your Agency in order to achieve satisfactory contract performance and meet your Agency’s expected outcomes. It outlines the potential difference between contractual performance expectations and meeting your Agency’s objectives. For example, the service or completed project may not meet community expectations.

As a post-contract review, this section ensures that your improvement process delivers superior outcomes both during the contracting process and in subsequent contracting activities.

This section applies to those managing the contracting process.

5.1 COMPARING RISK AND QUALITY MANAGEMENT

The relationship between Quality Management and Risk Management can largely be explained by understanding the concept of ‘variance’ and the role of planning.

Quality Management consists of both Quality Assurance (QA) and Quality Improvement (QI). QA seeks to understand and report retrospectively on any variance to objectives through measurement, audit and review. QI seeks to improve the current nature of processes for the purpose of reducing variance, or to re-evaluate objectives. This results from either learning from documented experience, or proactively making changes required to anticipate and meet new needs.

Risk assessment, an element within Risk Management, is largely focused on identifying, assessing and determining controls for one side of variance, adverse variance, on a predictive rather than retrospective basis. The degree of adverse variance from expected or required performance, is the same as the consequence level. Risk assessment adds likelihood in order to measure risk.

Most quality systems are based on the Plan-Do-Check-Act (PDCA) model.
Plan-Do-Check-Act quality model

<table>
<thead>
<tr>
<th>Activity</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Plan</td>
<td>Establish targets to meet commitments. Formulate policies and processes (including Risk Management) designed to deliver the commitments</td>
</tr>
<tr>
<td>Do</td>
<td>Implement the processes</td>
</tr>
<tr>
<td>Check</td>
<td>Monitor and measure the processes and outcomes, and compare to policies and objectives</td>
</tr>
<tr>
<td>Act</td>
<td>Take action to continuously improve process performance</td>
</tr>
</tbody>
</table>

Risk assessment (Chapter 4: Contracting Risk Management) and more broadly, Risk Management, are substantially a part of the Plan stage. The steps in Risk Management move towards risk treatment, which occurs before implementation (i.e., the Do step) in operating activities.

Both Quality and Risk Management make the same key assumption – that the targets around which variance is measured are realistic and represent what is truly required. Failure to set the required targets would mean that the risk and quality processes are measuring and reporting the wrong information and hence can lead to incorrect decision-making. Therefore, Agency objectives and targets must constantly be reviewed.

5.2 MEASURING QUALITY PERFORMANCE

Quality performance comes from placing well-defined quality criteria into the contract tender process and seeing that it has been appropriately measured and executed. To do this it is necessary to understand some general and detailed requirements for appropriate performance criteria and then ensure that a competency system is in place to execute the required performance.

**GENERAL REQUIREMENTS FOR QUALITY PERFORMANCE CRITERIA**

To introduce effective quality performance criteria:

- Include criteria in both the tender and contract conditions. In the contract, the *materiality* or importance of performance measures can be highlighted by separating those, which form part of contract conditions (for critical measures), or as warranties (for important, but not critical measures)
- Ensure the contractor regularly and rigorously monitors and reports operating performance indicators according to an agreed plan. The reports are sometimes referred to as ‘score-sheets’
- Assess the reports upon receipt, sign-off where compliant, note better than minimum compliance, capture non-compliance, regularly audit the accuracy and reliability of the information at critical stages (for projects) or at regular intervals for recurring activities
• Apply a ‘balanced scorecard’ approach, i.e., include performance indicators that are a combination of positive, negative, input and output indicators. This allows Agencies to measure and acknowledge higher than minimum contract performance. In addition, positive indicators often represent proactive management processes, accreditation and so on.

• Ensure the contract allows for practical remedies, including: a dispute resolution processes, the ability to suspend works without cost to the Agency, allowance for rework and catch up time, compensation for loss to the Agency or third parties, and in severe cases, termination of the contract.

ELEMENTS OF CONTRACT PERFORMANCE
The elements in a quality assurance and improvement system will depend upon the nature of the contract. The elements must represent all of what is important to meet Agency objectives. The following is a guide.

• Organisational capability, including technical and financial capacity, Quality Assurance and Risk Management.

• Organisational quality, including R&D, labour relations/HR management, competency formation (knowledge, qualifications, and skills), strategic management for continuous improvement and compliance with legislative requirements.

• Contract performance as indicated by claims, time and technical performance.

• Commitment to public policy and stakeholder interests, local content and local employment opportunities.

The performance indicators used in evaluating a contractor’s past performance at the offer stage need to be included in the measuring of contract performance.

DEVELOPING DETAILED PERFORMANCE INDICATORS
Each general performance area requires specific criteria according to a scoring mechanism. A scoring mechanism could be as simple as four levels:

1. More than adequate
2. Adequate
3. Marginally adequate, and
4. Inadequate.

Great care must be taken in choosing meaningful and fair indicators that can be verifiable or has a process that can be demonstrated. Not doing so could lead to either poor outcomes for the Agency (even if contract terms have been met), or expensive unplanned variations. Examples of indicators are included in the following sections.

CONTRACT PERFORMANCE
Some of the following indicators will need to be adjusted according measures that account for the number and size of past contracting activities, for example, contract size (cost), wages and salaries and number of employees.
CLAIMS PERFORMANCE

- Number of contract claims that proceed to a Notice of Dispute
- Worker’s compensation claims: total number, number over a certain dollar value (large amount), average monetary claim, and
- Evidence of OH&S system certification by a third party (a positive indicator)

TIME PERFORMANCE

- References from previous contracts similar in nature and size over the past two years that met target times (except circumstances outside of their control), and
- Demonstration of use of critical path process methodology (positive).

ORGANISATIONAL PERFORMANCE

TECHNICAL CAPACITY

Technical assessments require objective and subjective analysis and must be conducted by suitably qualified and experienced assessors. Contractors are to provide evidence of previous experience, and technical qualification relating to the following:

- Past performance of contractor
- Qualifications, experience, and past performance of key personnel
- Staffing resources
- Subcontract resources
- Physical resources, whether owned or hired
- Application capability, i.e., ability to apply expertise and resources
- Appreciation of the project/supply task, and
- Any special expertise or resource requirements.

FINANCIAL CAPACITY

Here contractors are expected to show both minimum standards of accounting and finance controls. They should have the financial resources to undertake the role and financial capacity to absorb adverse experiences on this contract and other works they might be undertaking during the same period.

Care should be taken to ensure that no one project or supply (including this contract) would account for a major part of their business – say, more than 30 per cent.

Some of the key criteria might include:

- Ability to produce monthly financial statements within a month of the financial report date
- Provision of forward budgets of balance sheet items, profit and loss, and, particularly, cash flow. (Must be audited for key contracts.)
- Provision of a comparison of actual to budget, with written analysis on variations
• Nomination and evidence shown of the qualified person to undertake the above, and

• Establishment of minimum financial ratios for the contractor’s financial performance, relating to net worth, cash flow and profitability. Examples include current liabilities not to exceed 85 per cent of current assets, total revenue not to exceed 12 times net tangible assets and net operating cash flow to be positive at all times.

Both the initial and ongoing financial analysis of the contractor must be undertaken. This requires qualified Agency personnel with credit analysis skills and experience. In addition, for larger and more financially-sensitive projects/purchases, the following additional information might be required:

• Work-in progress reports on other major projects
• Details of borrowings and borrowing limits
• Details of aged creditors and debtors list, and
• Details of guarantees, indemnities and contingent liabilities.

The contract should include a Notification of Changes in Circumstances clause that requires the contractor to advise of any material change as soon as they know it. Material change could be defined as something that would have a 10 per cent or more positive or negative impact in their net assets.

5.3 MEASURING COMPETENCY AND IMPROVEMENT

A key aspect of organisational quality is the performance indicator competency formation. This is the development and application of knowledge, qualifications and skills. Agencies need to know that both the contractor and they have a system of recruiting, developing and maintaining competent personnel.

One way is to ensure contractors and Agency personnel undertake competency-based training. This applies to all steps of the contracting process. Obtaining evidence of an effective training system is particularly important for long-term contract works where personnel can change.

Training and skills attainment must form part of the contractor evaluation/performance assessment process.

5.4 COMPETENCY-BASED TRAINING

Competency based training is both a diagnostic tool to determine competency needs and a quality improvement process that updates competency according to changing needs. The process can only work in an honest and ‘no-blame’ culture. It could be described in four stages:
1. SELF-ASSESSMENT
The individual assesses themselves against the competency standard. The individual compiles a portfolio of evidence containing notes about things they can do to demonstrate competence. The portfolio will also contain items such as references, certificates and letters that will help to show competence.

2. WORKPLACE ASSESSMENT
An assessor reviews the individual's self-assessment and portfolio of evidence. The assessor will interview the individual and spend time observing those performing skills on the job. The assessor provides feedback to the individual and identifies the areas needing development. A development plan is then compiled.

3. ON AND OFF-THE-JOB LEARNING AND DEVELOPMENT

4. REASSESSMENT
If the individual can then show competence against the required competencies and performance criteria, the qualification is awarded.

GENERAL REQUIRED COMPETENCIES
Agencies need to ensure that training programs form a part of contract requirements. There will be a need to appropriately categorise the required competencies according to different types of skills needed to perform and manage the contract. An example is to require competency training plans from contractors according to four skill types and three skill levels for each type.

Skill can be defined as obtaining the required information, assimilating it and applying it. The skill types can be divided into task skills, task management skills, contingency management skills and job/role environment skills.

TASK SKILLS
The requirement to perform tasks.

TASK MANAGEMENT SKILLS
The requirement to manage a number of different tasks. Task management skills capture the skills needed for people to plan and integrate a number of different tasks to achieve a complete work outcome.

CONTINGENCY MANAGEMENT SKILLS
These skills respond to irregularities and breakdowns in routine. It encompasses the skills used in allowing for irregularity, imperfections and the unknown, which come into play in day-to-day employment.

JOB/ROLE ENVIRONMENT SKILLS
The requirement to deal with the responsibilities and expectations of the work environment. It refers to the skills used in working with others, and in interacting with people from outside the enterprise, for example, customers, clients, and the general public.
Job/role environment skills also include adapting to the varied demands of employment across enterprises. The capacity to work with others and to adapt to different situations is central to successful performance.

Each of these four skills areas can be further categorised according the standard achieved according to three skill levels:

1. Basic. New persons
2. Intermediate. Detailed knowledge and supervision skills, and
3. Advanced. Either a master of some skill or senior executive competency.

For more information go to:-

Department of Education, Employment and Workplace Relations: - www.dest.gov.au

5.5 MONITORING AND ENFORCEMENT

Assurance involves a systematic examination of information that is evaluated against suitable criteria and results in periodic reports to management. It is then up to management to make informed and timely decisions particularly when the reports indicate non-compliance with performance criteria.

Monitoring and enforcement is a major activity that is often overlooked or given inadequate attention. The implications can be very serious. If the works of contractors are not effectively monitored and performance enforced, then problems could develop to critical levels.

Some possible reasons for inadequate monitoring and enforcement include:

- Some Agencies taking a conscious ‘gamble’ that the contractor will do what is required, and therefore the Agency does not need to apply resources to ensure performance is on track, i.e., reactive rather than proactive management
- Management not assigning Agency personnel to monitor performance. Typically, there might not have been any budget allocation for monitoring and review as part of the full costing (i.e., life-cycle cost) of the contracting activity
- Inadequate backup when the Agency contract manager is absent, and
- The responsible Agency personnel are themselves not being monitored by senior management or given the skills, time and resources to do the job effectively.

THE IMPORTANCE OF INDEPENDENCE TO THE LEVEL OF ASSURANCE

The level of assurance (i.e., confidence in the information) is a product of both the degree of independence of the assessor and their competence. In terms of independence, assurance is lowest when the auditor represents the contractor. Assurance increases when Agency employees undertake the audit activity. However, the Agency representative is often too close or entwined in the contract processes and decisions that are made.
Consequently a third party external assurance / audit expert provides the most independent auditor.

Your Agencies should adopt a higher level of assurance, i.e., use of external audit and assurance:

- At least occasionally during major and high risk contracts
- When a new or unknown contractor is being used, or
- When Agency staff lack competence in the audit, monitoring and evaluation role.

For more information go to:
Construction reporting system

5.6 CONTRACTOR INCENTIVES FOR IMPROVEMENT

It is recommended that contract terms include incentives for contractors to provide better outcomes than merely fulfilling minimum contract conditions. Better outcomes could be undertaking tasks more efficiently or effectively, or improving the quality or quantity of the output. In some industries this is referred as a form of partnering.

Contractors are often more likely to see better ways of undertaking a task. Consequently, their views on improvements need to be actively discussed through regular consultation with the Agency contract manager.

Generally, there is no incentive for contractors to provide a better service or outcome than required by the contract, particularly when to do so involves significantly more cost to them. They do, of course, have an incentive to improve their own processes and work methods that reduce costs.

Consequently, contractors need to have a real incentive to recommend quality improvements that are mutually beneficial. To encourage this, the contract could include terms that provide a financial incentive (say a proportion of reduced costs or improved value) when they provide a case for, or can demonstrate improvement in outcomes.

5.7 REVIEW ATTAINMENT OF AGENCY OBJECTIVES

Agencies need to review their own performance to ascertain if the objectives and performance indicators outlined in the original ‘Business Case’ have been met. If not, the reasons need to be analysed, recommendations for improvements made in the relevant area- such as processes, training, setting objectives and so on.

If there are any major deficiencies in contract outcomes, (or even incidents that could have led to a major loss), due to the actions or omissions of the contractor, Agency, or external factors – then a review and investigation is required.

For example, a contractor might successfully complete the building of a bridge according to specifications and performance criteria. The actual traffic flow could show that demand significantly exceeded expectations. Consequently new and more costly additional works are required to meet community expectations. In this example, the initial assessment of the need was miscalculated.
The reasons for major variations in outcomes to prescribed objectives need to be analysed and assessed. Once again, this is not to be used for the purpose of applying blame, but for the purpose of learning and providing a sustainable improvement in the contracting process.

5.8 THE NEED FOR A COMPLETE MANAGEMENT FRAMEWORK

Quality and Risk Management processes that support contracting activities might not be fully effective if, for example, there is a failure to adequately resource its needs, to obtain the required support from executive and line management, or other inter-related business units do not co-ordinate their activities with the contracting unit.

To be effective the PDCA model can be applied to all elements of the contracting system.

The table below provides a general guide to where the quality process needs to be applied by linking the PDCA model to five key factors required in any successful organisation.

**PDCA with factors required for successful contracting**

<table>
<thead>
<tr>
<th>REQUIRED OUTCOMES that are clear and exist for all contract stages</th>
<th>PEOPLE competencies and how they are determined</th>
<th>HARDWARE and FACILITIES that are fit for purpose’</th>
<th>METHODS appropriate to the work.</th>
<th>MANAGEMENT who provide: Commitment, Structure; Accountability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Plan</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Do</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Check</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Act</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>

Both executive management and line management need to recognise and strive for the establishment and improvement of an Agency ‘management framework’. A complete framework extends beyond ‘concrete’ checklists to assessing values, cultures and relationships. An example of what this might include is shown in a model issued by the Australian Quality Council (AQC).

**THE AUSTRALIAN BUSINESS EXCELLENCE FRAMEWORK (ABEF)**

In this model a holistic view is taken. Agencies or Departments are seen as an integrated system, where all business units are inter-dependent and are required to function together efficiently and effectively to achieve organisational objectives. The model below, the ‘Australian Business Excellence Framework 2001, describes the relationship between seven critical Agency components.
Accompanying each component is a list of assessment criteria (not provided here). A key aspect of the framework is an assessment process to determine how well your Agency is meeting the criteria and hence indicates the effectiveness of management practices. While all seven categories are important to the effectiveness of contracting, of particular importance to contracting is the category - ‘Processes, Products and Services’.

The assessment process involves scoring of attainment against criteria in each category. Assessments can take the form of a ‘self assessment’. However, more accurate and reliable results will come from trained assessors of management systems, either employed by the Agency or in the form of external assessors. (The AQC and many large consultancy firms provide assessors).

The ABEF contains all the requirements of the ISO 9004:2000 system.

This framework provides a useful tool to take stock of where your Agency is now and to involve your people in getting where you want to be in the future. It is recommended that Agencies measure and improve the adequacy of their management systems by using a readily available and suitable model such as the ABEF.

ABEF assessment system: [www.aqc.org.au](http://www.aqc.org.au) or call 1800 060 830
MANAGING CONTRACTING RISK

APPENDICES TO THE GUIDE FOR NSW GOVERNMENT AGENCIES

This Guide is confidential for NSW Government Treasury Managed Fund Member Agencies.
The NSW Self Insurance Corporation (SICorp) was created through the enactment of the NSW Self Insurance Corporation Act 2004. This Act established SICorp to operate one or more Government managed fund schemes and to enter into agreements or arrangements with other persons to provide services (as agents or otherwise) in relation to the operation of the any Government managed fund scheme.

SICorp's main role is the administration of the Treasury Managed Fund (TMF), which provides cover for all insurance exposures faced by general government sector budget dependent agencies (other than compulsory third party insurance) and other participating public sector agencies.

Suncorp Risk Services (SRS) works with clients across the public sector in NSW providing strategic level risk management consulting services on behalf of SICorp. SRS focus is on addressing issues of a strategic nature that may impact SICorp and/or individual agencies. In doing so, they provide consultancy and research services in the application of enterprise wide risk management and occupational health and safety and injury management.

For more information....

If you would like to discuss this report, please contact:
Name: Gary McCourt
Title: Risk Management Consultant
Phone (02) 8121 0470
Email: Gary.McCourt@suncorp.com.au
Contents

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Appendix 4: Plan the Purchase 21
Appendix 5: Develop the Tender 33
Appendix 6: Invite and Receive Offers 40
Appendix 7: Create a Contract Management Plan 44
Appendix 8: Example Contractor safety process 49
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Appendix 1: Assistance and Resources

**In this section...**

Main contacts (GIO TMF and Department of Services, Technology & Administration Public Works Division)

Sources of supplementary information

Appendix 1 provides contact details for the GIO Treasury Managed Fund: your Agency’s main source of information about contracting risks; and the Department of Services, Technology & Administration Public Works Division, who manage major contracts on behalf of most Agencies.

Also included is a comprehensive list of supplementary resources, including policies, guidelines, codes of practice, legislation and discussion papers. Most of these have related Internet addresses.

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**A1.1 Contacts**

**Department of Services, Technology & Administration Public Works Division**

Corporate brochures


**Internal Audit Bureau of NSW**

The IAB is a Government trading enterprise, which provides direct or contracted management services for the Public sector on a fee-for-service basis. Services relevant to contracting include:

- Probity audits;
- Internal audit of risk and compliance;
- Quality assurance reviews; and,
- Business planning.

Phone: (02) 9261-1090: Email: intaud@iab.nsw.gov.au

Level 3, 507 Kent St, Sydney, NSW, 2000
# A1.2 Resources

This section provides references to legislation, policies, guidelines, codes of practice and discussion papers.

| Area | Issued by | Latest Version | Title | Location.
<table>
<thead>
<tr>
<th></th>
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<tbody>
<tr>
<td>Legislation</td>
<td>NSW Govt.</td>
<td>1999</td>
<td>General Purchasing Delegation – for ‘not in contract’ goods and services</td>
<td><a href="http://www.supply.dpws.nsw.gov.au/NSW+Supply/Procurement+Policy">www.supply.dpws.nsw.gov.au/NSW+Supply/Procurement+Policy</a> Explains the appropriate quotation / tender procedures according to dollar amounts for quotations (up to $100,000) and tenders (over $100,000) applicable to Departments / Agencies listed in Schedule 1 of Public Sector Management (Goods and Services) Regulation (2000) NSW</td>
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<tr>
<td>Agency-specific legislation</td>
<td>Various</td>
<td>Various</td>
<td>Agency-specific</td>
<td>Note: Agencies need to identify their own legislation and internal policies, which further describe their obligations during the contracting process</td>
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<tr>
<td>Procurement General</td>
<td>DPWS Public Works Division</td>
<td>1999</td>
<td>Policy Statement</td>
<td><a href="http://www.dpws.nsw.gov.au/policy/areas+of+expertise/procurement/index.htm">www.dpws.nsw.gov.au/policy/areas+of+expertise/procurement/index.htm</a> An overarching framework. Objectives, Principles, Strategies and required actions for a consistent whole of Government approach to procurement. The policy promotes a strategic approach to procurement and increased accountability through a policy of buying less, buying better and buying smarter. The policy aims to achieve better value for money for the taxpayers dollars; to provide a consistent and cohesive face to industry; and to achieve economic, regional, environmental and social objectives in delivering services to the community</td>
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<tr>
<td>Area</td>
<td>Issued by</td>
<td>Latest Version</td>
<td>Title</td>
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<tr>
<td>Procurement General</td>
<td>DPWS</td>
<td>Latest Version</td>
<td>A Guide to NSW Government Period Contracts</td>
<td>Regularly updated hard copy from DPWS Supply Unit. Comprehensive guide providing a list of all current Period Contracts and the Contact Officer administering the contract</td>
</tr>
<tr>
<td>Procurement General</td>
<td>DPWS</td>
<td>2000</td>
<td>Economic development</td>
<td><a href="http://www.dpws.nsw.gov.au/policy/areas+of+expertise/procurement/index.htm">www.dpws.nsw.gov.au/policy/areas+of+expertise/procurement/index.htm</a> Guidelines for supporting local and NZ service providers. Agencies with an annual procurement budget exceeding $5million are required to enter into a Memorandum of Understanding with the NSW Industrial Supplies Office (ISO). The ISO must be contacted to obtain direction before proposed purchases of more than $1million. In tender evaluations, Agencies are required to either a) apply the NSW Government Preference Scheme i.e., impose a notional increase the imported content of tender prices by 20% or b) require tender’s to prepare an Industry Impact Statement for proposed high value and strategic contracts</td>
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<tr>
<td>Procurement General</td>
<td>DPWS</td>
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<td>NSW Government Procurement Manual</td>
<td>Guidelines to assist buyers and service providers obtain 'value- for money'</td>
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<tr>
<td>Procurement General</td>
<td>DPWS</td>
<td>1999</td>
<td>Electronic Procurement, Taking up the challenge</td>
<td>Discussion paper only</td>
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<tr>
<td>Procurement General</td>
<td>NSW Audit Office</td>
<td>2000</td>
<td>Contracting Out Review Guide</td>
<td>Looks at dangers of reduced visibility and monitoring of performance</td>
</tr>
<tr>
<td>Procurement Services</td>
<td>DPWS</td>
<td>--</td>
<td>Service Competition Guidelines</td>
<td>Hard copy Provides a guide to determine if whether Agencies need to undertake a service competition process</td>
</tr>
<tr>
<td>Area</td>
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<td>Latest Version</td>
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<td>Procurement Services</td>
<td>DPWS Public Works Division</td>
<td>2000</td>
<td>Service provider performance management</td>
<td>Hard copy. Outlines a performance report, rating system and requirement to exchange information with other Agencies</td>
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<tr>
<td>Capital works</td>
<td>DPWS Public Works Division</td>
<td></td>
<td>NSW Government Capital Project Procurement Manual (CPPM)</td>
<td>Hard copy: Detailed advice on engagement of contracted professional services such as architects, engineers and so on. Cost: $116.60</td>
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<td>Area</td>
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<td>Title</td>
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<tr>
<td>Capital works</td>
<td>DPWS Public Works Division</td>
<td></td>
<td>Information Technology in Construction Making IT Happen</td>
<td><a href="http://www.dpws.nsw.gov.au/makingIThappen">www.dpws.nsw.gov.au/makingIThappen</a> - Sets out a strategy to improve productivity through improved communication enabled by IT and communication networks, across all aspects of construction and operation of capital works projects</td>
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<td>Capital works</td>
<td>DPWS Public Works Division</td>
<td></td>
<td>Security of Payment</td>
<td><a href="http://www.dpws.nsw.gov.au/sop">www.dpws.nsw.gov.au/sop</a> - Initiatives for govt. projects to improve prospects for all parties down the contract chain, and provisions to afford greater protection and better access to remedies</td>
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<td>Capital works</td>
<td>DPWS Public Works Division</td>
<td>1998</td>
<td>Environmental Management Systems- Guidelines</td>
<td><a href="http://www.dpws.nsw.gov.au/environment">www.dpws.nsw.gov.au/environment</a> - Encourage the construction industry to proactively manage environmental issues, which will lead to the industry being recognised for its high Ecologically Sustainable Development (ESD) performance by both clients and the wider community</td>
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<tr>
<td>Capital works</td>
<td>DPWS Public Works Division</td>
<td>1993</td>
<td>Risk Management Guidelines</td>
<td>Guidelines to manage risks for capital works valued in excess of $5 million</td>
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<td>Capital works</td>
<td>DPWS Public Works Division</td>
<td>2000</td>
<td>Capital works up to $500,000- Guidelines</td>
<td>Guidelines for Agencies to manage construction and maintenance contracts for projects with contract under $500,000 in value.</td>
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<tr>
<td>Capital works</td>
<td>DPWS Public Works Division</td>
<td></td>
<td>Building a future together - Opportunities for Aboriginal people and enterprises in the construction industry in NSW</td>
<td><a href="http://www.dpws.nsw.gov.au/buildingtogether">www.dpws.nsw.gov.au/buildingtogether</a> - Aims to stimulate broad-ranging and constructive debate on ways to improve employment, training and business development opportunities for Aboriginal people and enterprises in the construction industry in NSW.</td>
</tr>
</tbody>
</table>
Appendix 2: Identify and assess risks

In this section...
- Examples of risk levels
- Identifying contracting risks
- Possible risks in the contracting process
- Model Risk Assessment form

Appendix 2 is a supplementary resource for identifying and assessing risks during the contracting process. This section ties-in with Chapter 4: Contracting Risk Management.

This section provides examples of risk levels that may be used when assessing risk severity. It includes a list of possible risks that may be encountered in the contracting process that can be tailored to your Agency. An example of a Risk Assessment form is included.

Note: See AS/NZS ISO 31000:2009 Risk management - Principles and guidelines for example risk definitions, risk classifications and risk analysis likelihood ratings.

A2.1 Sample risk levels

The matrix on the following page is an example of risk levels that may be relevant to contracting. These risks are not necessarily representative of actual risk levels.
<table>
<thead>
<tr>
<th>FREQUENCY</th>
<th>High (5)</th>
<th>Significant (4)</th>
<th>Medium (3)</th>
<th>Low (2)</th>
<th>Negligible (1)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Consequence</strong></td>
<td><strong>High (5)</strong></td>
<td><strong>Significant (4)</strong></td>
<td><strong>Medium (3)</strong></td>
<td><strong>Low (2)</strong></td>
<td><strong>Negligible (1)</strong></td>
</tr>
<tr>
<td>Catastrophic (5)</td>
<td>Inadequate Scope (major project)</td>
<td>Major cost overrun (prime-costs)</td>
<td>Major Project ‘white- elephant’</td>
<td>Major damage to own building</td>
<td>Earthquake</td>
</tr>
<tr>
<td>Major (4)</td>
<td>Inadequate Scope (large project)</td>
<td>Failure of critical contracted service</td>
<td>Contractor failure to meet major performance criteria</td>
<td>Contractor fatality</td>
<td>Failure of critical contracted service</td>
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<td>Failure of selection criteria</td>
<td>Failure of critical contracted service</td>
<td>Contractor failure to meet major performance criteria</td>
<td>Contractor fatality</td>
<td>Failure of critical contracted service</td>
<td>Inadequate Scope (large project)</td>
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<tr>
<td>Medium (3)</td>
<td>Reduction in quality outcomes</td>
<td>Failure of selection criteria</td>
<td>Contractor failure to meet major performance criteria</td>
<td>Contractor fatality</td>
<td>Failure of critical contracted service</td>
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<td>Inadequate Scope (medium size contract)</td>
<td>Contractor failure to meet major performance criteria</td>
<td>Contractor failure to meet major performance criteria</td>
<td>Contractor fatality</td>
<td>Failure of critical contracted service</td>
<td>Inadequate Scope (large project)</td>
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<tr>
<td>Contractor-caused TPPD/injury</td>
<td>Contractor failure to meet major performance criteria</td>
<td>Contractor failure to meet major performance criteria</td>
<td>Contractor fatality</td>
<td>Failure of critical contracted service</td>
<td>Inadequate Scope (large project)</td>
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<td>Minor injury to contractor</td>
<td>Contractor failure to meet major performance criteria</td>
<td>Contractor failure to meet major performance criteria</td>
<td>Contractor fatality</td>
<td>Failure of critical contracted service</td>
<td>Inadequate Scope (large project)</td>
</tr>
<tr>
<td>Inadequate Scope (small contract)</td>
<td>Contractor failure to meet major performance criteria</td>
<td>Contractor failure to meet major performance criteria</td>
<td>Contractor fatality</td>
<td>Failure of critical contracted service</td>
<td>Inadequate Scope (large project)</td>
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<tr>
<td>Low (2)</td>
<td>Minor injury to contractor</td>
<td>Contractor failure to meet major performance criteria</td>
<td>Contractor fatality</td>
<td>Failure of critical contracted service</td>
<td>Inadequate Scope (large project)</td>
</tr>
<tr>
<td>Inadequate Scope (small contract)</td>
<td>Contractor failure to meet major performance criteria</td>
<td>Contractor failure to meet major performance criteria</td>
<td>Contractor fatality</td>
<td>Failure of critical contracted service</td>
<td>Inadequate Scope (large project)</td>
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<tr>
<td>Low (2)</td>
<td>Minor injury to contractor</td>
<td>Contractor failure to meet major performance criteria</td>
<td>Contractor fatality</td>
<td>Failure of critical contracted service</td>
<td>Inadequate Scope (large project)</td>
</tr>
<tr>
<td>Inadequate Scope (small contract)</td>
<td>Contractor failure to meet major performance criteria</td>
<td>Contractor failure to meet major performance criteria</td>
<td>Contractor fatality</td>
<td>Failure of critical contracted service</td>
<td>Inadequate Scope (large project)</td>
</tr>
<tr>
<td>Minor (1)</td>
<td>Cash theft</td>
<td>Contractor failure to meet major performance criteria</td>
<td>Contractor fatality</td>
<td>Failure of critical contracted service</td>
<td>Inadequate Scope (large project)</td>
</tr>
<tr>
<td>Inadequate Scope (small contract)</td>
<td>Contractor failure to meet major performance criteria</td>
<td>Contractor failure to meet major performance criteria</td>
<td>Contractor fatality</td>
<td>Failure of critical contracted service</td>
<td>Inadequate Scope (large project)</td>
</tr>
</tbody>
</table>
A2.2 Identifying contracting risks

There are potentially many contracting risks. In order to assist in the risk identification process it can be useful look at some generic ‘risk areas’. However, the inter-relatedness of risk areas must be recognised. The following risk areas by Source, Operation and Contracting Process provide a possible framework for Agencies in identifying and categorising contracting risks and are examples only, not definitive lists:

**RISK AREAS BY SOURCE**

<table>
<thead>
<tr>
<th>Risk Area</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agency</td>
<td>Risks largely derived from Agency decisions and performance. E.g., inadequate specifications and Agency fraud</td>
</tr>
<tr>
<td>Contractor</td>
<td>Risks largely derived from contractor decisions and performance. E.g., poor performance and contractor fraud.</td>
</tr>
<tr>
<td>Contractual</td>
<td>Risk associated with contract terms and conditions. E.g., unclear or omitted terms adequacy of insurance and allocation of contractual liabilities.</td>
</tr>
<tr>
<td>External</td>
<td>External factors largely out of the control of the contracting parties. E.g., Weather impacts, change in Government policy, public opinion, failure of key ‘up-stream’ supplier to contractor.</td>
</tr>
</tbody>
</table>

**RISK AREAS BY AGENCY OPERATION**

<table>
<thead>
<tr>
<th>Risk Area</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strategy</td>
<td>Senior management decisions that either fail to contract, or enter into contracts (or unenforceable agreements) that are inconsistent or inappropriate with the Agency:</td>
</tr>
<tr>
<td></td>
<td>• Objectives (i.e., ‘direction’);</td>
</tr>
<tr>
<td></td>
<td>• Goals (i.e., ‘specific targets’);</td>
</tr>
<tr>
<td></td>
<td>• Stakeholder interests; and,</td>
</tr>
<tr>
<td></td>
<td>• Ability to absorb change.</td>
</tr>
<tr>
<td>Inputs</td>
<td>• Failure to identify key Agency needs;</td>
</tr>
<tr>
<td></td>
<td>• Scope and specifications that fail to meet key Agency needs;</td>
</tr>
<tr>
<td></td>
<td>• Inappropriate choice of contractor or contracted goods and services;</td>
</tr>
<tr>
<td></td>
<td>• Failure to obtain essential contracted service, product, construction, plant, equipment, materials, stock and software;</td>
</tr>
<tr>
<td></td>
<td>• Procurement fraud.</td>
</tr>
<tr>
<td>Outputs</td>
<td>• Reduction in effectiveness or usage of services or products;</td>
</tr>
<tr>
<td></td>
<td>• Inability to meet required quality or demand for services;</td>
</tr>
<tr>
<td></td>
<td>• Interruption to delivery of services, such as breakdowns, which could cause major delays or a total failure to deliver.</td>
</tr>
<tr>
<td>Category</td>
<td>Risks</td>
</tr>
<tr>
<td>------------------------</td>
<td>----------------------------------------------------------------------</td>
</tr>
</tbody>
</table>
| **Finance**            | • Failure to identify or fund the on-going life-cycle costs required to maintain the contracting activity and asset management plan;  
                          • Significant uncertainty of contracted- costs (or income) E.g., exposure to volatility of local market prices, interest rates and foreign exchange;  
                          • Unrealistic budgets;  
                          • Maintaining high cost and inefficient contract services;  
                          • Failure to obtain sufficient funding or obtain approval for funding;  
                          • Financial fraud. |
| **Property**           | Failure to maximise the value of real and intangible property through:  
                          • Protection from theft, damage or destruction;  
                          • Appropriate life-cycle management (i.e., repairs, maintenance and timely disposal).  
                          • Failure to obtain ownership when required (esp. intellectual property);  
                          • Failure to recruit expert staff to manage the contracting process;  
                          • Loss of key persons in contract management;  
                          • Inadequate training or supervision;  
                          • Industrial disputation. |
| **Human resources**    |                                                                 |
| **Information and communication** | Failure to design the required contractor information systems (i.e., failure to capture, apply in a useable form, prevent loss or stolen records, inability to retrieve information, lack of information integrity, untimely information and loss of confidentiality);  
                                                                 • Inadequate consultation, monitoring and reporting of contractor performance. |
| **Health and safety**  | Accidents, assaults, adverse health impacts, shock or stress to contractors, subcontractors, staff, clients (including other users), visitors and other third parties.  
                          Failure to assess the OHS impact of procurement choices. |
| **Environment**        | Adverse impact from pollution or degradation on the quality of soil, air, water, noise, flora and fauna.  
                          Failure to assess the environmental impact of procurement choices. |
| **Legal**              | • Contract terms that are inadequate or omitted.  
                          • Non-compliance by Agency or contractor with contract terms, statutes, regulations, or common law. |
| **Reputation and image** | Damaged reputation or image- whether real or perceived.  
                          Inadequate public relations management. |
RISK AREAS ACCORDING TO THE CONTRACTING PROCESS

The management of risks is required throughout the contracting process. The nature of risks being managed will differ along the process. The following is an outline of the key risk areas:

<table>
<thead>
<tr>
<th>Phase</th>
<th>Stage</th>
<th>Key Risk Areas</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Contract planning</td>
<td>Identify the Need</td>
<td>Risks that could threaten the success of achieving organisational objectives. (See 2.8). If major risks are identified, and cannot be cost-effectively reduced to an acceptable level - then don’t proceed!</td>
</tr>
<tr>
<td></td>
<td>Plan the Purchase</td>
<td>Risks in the target market, stakeholder consultation, method of inviting offers, evaluation criteria, specification and design</td>
</tr>
<tr>
<td></td>
<td>Develop the Tender</td>
<td>Either omission of necessary conditions, or including inappropriate conditions for the Tender process, the Contract or Specification</td>
</tr>
<tr>
<td>2. Contract formation</td>
<td>Invite and receive Offers</td>
<td>Risks associated with providing consistent and fair information to the target market, and in receipt of expressions of interest / offers</td>
</tr>
<tr>
<td></td>
<td>Evaluate Offers</td>
<td>Risk of conclusions that are inconsistent with tender criteria</td>
</tr>
<tr>
<td></td>
<td>Negotiate and Apply Due Diligence</td>
<td>Risks of substantially altering the nature of tender conditions, of assuming excessive contractual risks, or not checking that the tenderer meets required criteria</td>
</tr>
<tr>
<td>3. Contract management</td>
<td>Manage the transition</td>
<td>(If applicable) risks of inadequate handover of knowledge and experience from previous contractor (or Agency) to the new contractor</td>
</tr>
<tr>
<td></td>
<td>Contract Operation</td>
<td>A multitude of risks associated with how activity will be managed and performance is monitored, preventing and preparedness for interruptions, and managing variations</td>
</tr>
<tr>
<td></td>
<td>Review Contract Options</td>
<td>Risks of not learning from Agency and contractor’s experience wrongly renewing/finalising the contract when work is incomplete or not monitoring the defects period</td>
</tr>
</tbody>
</table>
A2.3  List of possible risks in the contracting process

Initially, the risk identification and quantification process might produce considerable ‘unreliable estimates’. However, over time accuracy will improve as close monitoring and review is undertaken from a cross section of experienced management or external consultants.

The next few pages provide examples of contracting risks in the contracting process. Detailed explanations and further understanding of many of these risks are provided in the Appendix and can be located by the reference number provided.

Agencies can use this information as a guide to identify, rank and establish treatment plans to manage their own contracting risks.

<table>
<thead>
<tr>
<th>Phase 2: Contract formation</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Invite and receive offers</strong></td>
<td>4</td>
</tr>
<tr>
<td>(3.1) Wrongful exclusion of applicant from tender process</td>
<td></td>
</tr>
<tr>
<td>(7.1) Misleading or deceptive conduct</td>
<td></td>
</tr>
<tr>
<td>(7.2) Unconscionable conduct</td>
<td></td>
</tr>
<tr>
<td><strong>Evaluate offers</strong></td>
<td>5</td>
</tr>
<tr>
<td>(7.3) Anti-competitive conduct</td>
<td></td>
</tr>
<tr>
<td><strong>Negotiate and apply due diligence</strong></td>
<td>6</td>
</tr>
<tr>
<td>(1.5) Excessive assumption of commercial risks</td>
<td></td>
</tr>
<tr>
<td>(8.4) Bid or tender rigging</td>
<td></td>
</tr>
<tr>
<td>(8.5) Bid or tender fixing</td>
<td></td>
</tr>
<tr>
<td>(8.6) Kickbacks and inducements</td>
<td></td>
</tr>
<tr>
<td>(10.3) Inadequate indemnity and liability</td>
<td></td>
</tr>
<tr>
<td><strong>Finalise and award the contract</strong> (unless it is in standard form)</td>
<td>7</td>
</tr>
<tr>
<td>(2.4) Void contract</td>
<td></td>
</tr>
<tr>
<td>(5.3) Unauthorised contract</td>
<td></td>
</tr>
<tr>
<td>(3.3) Failure to finalise contract before practical commencement</td>
<td></td>
</tr>
</tbody>
</table>
### Phase 3: Contract management

#### Manage the transition

<table>
<thead>
<tr>
<th>Risk Event</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1.1) Failure to integrate out-sourced activities</td>
<td>8</td>
</tr>
<tr>
<td>(1.3) Disruption from outsourcing strategy</td>
<td></td>
</tr>
<tr>
<td>(3.4) Breach of contractor confidentiality</td>
<td></td>
</tr>
<tr>
<td>(6.9) Theft of Agency / client / third party property</td>
<td></td>
</tr>
<tr>
<td>(6.10) Assault by contractor on Agency staff/client/intruder and so on.</td>
<td></td>
</tr>
<tr>
<td>(6.11) Unauthorised release by contractor of Agency/client information</td>
<td></td>
</tr>
<tr>
<td>(6.12) Breach of Agency security</td>
<td></td>
</tr>
</tbody>
</table>

#### Manage the operation

<table>
<thead>
<tr>
<th>Risk Event</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>(4.1) Cost overrun from additional works.</td>
<td>9</td>
</tr>
<tr>
<td>(4.2) Cost overruns from reworks (due to principal’s variation).</td>
<td></td>
</tr>
<tr>
<td>(4.3) Failure to benefit form reduced scope/ innovation</td>
<td></td>
</tr>
<tr>
<td>(4.4) Latent conditions</td>
<td></td>
</tr>
<tr>
<td>(4.5) Variation not approved by Agency but upheld in law</td>
<td></td>
</tr>
<tr>
<td>(3.4) Breach of contractor confidentiality</td>
<td></td>
</tr>
<tr>
<td>(5.2) Inadvertent breach by Agency</td>
<td></td>
</tr>
<tr>
<td>(5.4) Adverse impact from contract termination</td>
<td></td>
</tr>
<tr>
<td>(5.5) Major cost overrun</td>
<td></td>
</tr>
<tr>
<td>(6.2) Major delay in contract completion</td>
<td></td>
</tr>
<tr>
<td>(6.3) Severe damage by contractor to Agency/third party’s property</td>
<td></td>
</tr>
<tr>
<td>(6.5) Major interruption to Agency/third party operations</td>
<td></td>
</tr>
<tr>
<td>(6.6) Death, major injury or adverse health impact</td>
<td></td>
</tr>
<tr>
<td>(6.7) Severe adverse impact on the environment</td>
<td></td>
</tr>
<tr>
<td>(6.8) Major fire, explosion or implosion</td>
<td></td>
</tr>
<tr>
<td>(6.9) Theft of Agency or client third party property</td>
<td></td>
</tr>
<tr>
<td>(6.10) Assault by contractor on Agency staff, client or intruder etc.</td>
<td></td>
</tr>
<tr>
<td>(6.11) Unauthorised release by contractor of Agency or client information</td>
<td></td>
</tr>
<tr>
<td>(6.12) Breach of Agency security</td>
<td></td>
</tr>
<tr>
<td>(6.13) Contractor insolvency</td>
<td></td>
</tr>
<tr>
<td>(8.1) Fraudulent misappropriation of receipts or payments</td>
<td></td>
</tr>
<tr>
<td>(8.2) Theft of cash</td>
<td></td>
</tr>
<tr>
<td>(8.3) Contractor pay or invoicing fraud</td>
<td></td>
</tr>
<tr>
<td>(8.7) Work done or goods supplied for private purposes</td>
<td></td>
</tr>
<tr>
<td>(8.8) Dummy suppliers</td>
<td></td>
</tr>
<tr>
<td>(9.1) Uninsured contractor or Agency</td>
<td></td>
</tr>
<tr>
<td>(9.2) Under insured contractor or Agency</td>
<td></td>
</tr>
<tr>
<td>(9.3) Contractor breach of insurance policy or condition</td>
<td></td>
</tr>
<tr>
<td>Evaluate performance</td>
<td>10</td>
</tr>
<tr>
<td>----------------------</td>
<td>----</td>
</tr>
<tr>
<td>(5.7) Failure to notify contractor/supplier of defects within defects/warranty period</td>
<td></td>
</tr>
<tr>
<td>(6.1) Failure to meet contract specifications</td>
<td></td>
</tr>
<tr>
<td>Review contract options</td>
<td>11</td>
</tr>
<tr>
<td>i.e., complete (handover), extend or renew</td>
<td></td>
</tr>
<tr>
<td>(5.6) Loss or failure to own contractor’s intellectual property</td>
<td></td>
</tr>
<tr>
<td>(7.4) Product liability</td>
<td></td>
</tr>
</tbody>
</table>

### A2.4 Model risk assessment form

The following risk assessment form is an example of a form your Agency may use to assess various significant risks. Use the headings as a basis when creating your own forms. The assessor should:

- Complete the form in a level of detail befitting the risk level
- Use the form to make recommendations when analysing risks, and
- File the form on a database for future reference.
Risk assessment form

Unit: .................................................................................................................................................. 
Location: ........................................................................................................................................ 
Sub-area: ................................................................................................. Date: .......................... 
Risk: Third party injury or property damage by contractor (significant). Risk number: ............. 

Main scenarios

• Injury or loss to staff, client, visitor or other, - accidentally on Agency premises E.g., slip, trip, fall, impact
• Impacting third party / client / customer activities at their premises E.g., maintenance activities on client’s premises - for example, an explosion of fire resulting from conducting hot work without an appropriate hot work permit
• Typical risks for construction jobs are 'spray' onto Agency and visitor plant and vehicles, or neighbouring property by wet concrete during pours; coating, painting or sandblasting activities
• Fires and explosions impacting neighbouring businesses. Agency premises have flammable materials in drum stores and large quantities of compressed flammable gases.

Recommendations/comments (see attached for detail of assessment)

1. Review Safety Management Plan with contractor
2. Review the ‘standard of the standards’, i.e., adequacy of standards and benchmarks used in work methods
3. Investigate experience or concerns with neighbouring businesses
4. Contract requires consistent tight monitoring because contract indemnity and insurance limits- both at $10m, are below potential maximum loss scenario of $15ms

Prepared by: .......................................................... Date: ..........................
Decision: .................................................................................................................................
..........................................................................................................................................................

Managing Contracting Risk Appendices
Issue 2, January, 2010
Analysis supporting recommendations

1. The most likely causes are:
   • Inadequate housekeeping or storage conditions
   • Inadequate control or management of contractor or visitor activities, or
   • Inadequate control of operations.

2. Major risk drivers are:
   • Number of visitors to Agency premises
   • Housekeeping standards and control systems
   • Quality of workplace design and controls
   • Separation of neighbouring businesses from Agency premises, and
   • Quality of operational controls.

3. Might result in:
   • Third party compensation claims for injury or property damage
   • Business interruption compensation claims, or
   • Adverse media coverage.

4. Current defences:
   • Agency/contractor Management System Support:
     (re: goals, ‘hardware’, competency, work methods and system sustainability)
     • Contractor senior management site inspection with their OHS Manager
     • Contractor’s OHS and Contract Manager part of equipment evaluation committee, and
     • Strict supervision and training of contractor staff according to competency level and until site familiarisation program completed.
   • General controls:
     • Joint Agency/contractor risk assessment before commencement of next stage of work, and
     • Performance based incentives for OHS in contract.
   • Application controls:
     • Site Safety Management Plan, and
     • Agency audit, pre-arranged and on the spot.

Preparedness plans: (e.g., continuity/emergency response/crisis): nil
### Consequences (impact to Agency - shown below)

**Rating 3**

<table>
<thead>
<tr>
<th>Monetary cost to Agency:</th>
<th>Legal liabilities as below</th>
</tr>
</thead>
<tbody>
<tr>
<td>People:</td>
<td>Serious injury</td>
</tr>
<tr>
<td>Environment:</td>
<td>N/A</td>
</tr>
<tr>
<td>Legal liability:</td>
<td>Compensation claims for injury or property damage</td>
</tr>
<tr>
<td>Public perception:</td>
<td>Local media coverage</td>
</tr>
</tbody>
</table>

### Likelihood

**Rating 4**

**Comment:** Significant likelihood - supported by history and inherent risk factors

### Resulting risk level

Significant

**Accountability:** Agency Contract Manager

**Documentation:** Project OHS&R Management Plan

**Independent review:** Allowed in contract in case of dispute arising from performance or cause.

### Key performance indicators

- Number of third party incidents/accidents
- Number of third party compensation claims per cost centre per year
- Dollar value of third party compensation claims per cost centre last year
- Completion of annual public liability audit
- Hazard/ housekeeping inspection program with records in files up-to-date
- Recommendations from hazard/ housekeeping inspection program completed within designated timeframe

### Risk financing strategy

<table>
<thead>
<tr>
<th></th>
<th>Limit</th>
<th>Deductible</th>
<th>Special conditions and sub-limits</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. Agency loss/liability: - TMF</td>
<td>Nil</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Self financed</td>
<td></td>
<td></td>
</tr>
<tr>
<td>B. Contractor insurance(s)</td>
<td>Covered by broad-form public liability insurance</td>
<td>$10m</td>
<td>-</td>
</tr>
<tr>
<td>C. Projects covered by contract works</td>
<td>$5m</td>
<td>$100k</td>
<td></td>
</tr>
</tbody>
</table>

**Compare to**

- Estimated maximum reasonable loss: $15m
- Contract indemnity limit: $10m
Appendix 3: Develop the Business Case

In this section...
Benefits of creating a Business Case
Quantitative analysis techniques
Risk analysis

Appendix 2 described how to develop a Business case for planning the procurement process and justifying a project’s feasibility. This section is a supplement to Error! Reference source not found. and ties-in to planning the contracting decision.

A3.1 Benefits of creating a Business Case

The Business Case forms the foundation for the procurement planning process and is highly recommended for all projects that are high value, complex or strategic. It involves a rigorous assessment of a proposal in terms of all the costs, benefits, risks and options and provides the public authority with a reality check to:

- Ensure the initiative is feasible;
- Identify the preferred strategy and pathway;
- Confirm that the option chosen will meet the objectives set.

This process imposes a discipline on decision makers and requires them to consider all available options, to recognise the baseline costs and to address all the issues and risks involved in making the right decision. The Business Case should show expected cash flows and include the rationale for quantifying benefits and costs. It should also identify benchmarks and critical success factors to assess each option, along with a formal analysis of all significant risks. A good Business Case should address the following key issues:

- To what core function does the proposal contribute?
- Is the purchase absolutely necessary?
- What alternatives have been considered?
- What is the likely cost of the requirement and the source of funds?
- What benefits will it deliver above existing arrangements?
- Do the benefits of the proposal justify the costs?
- What risks are presented by the proposal?
- Alignment with Government policy, directions and strategic objectives;
- Ability to satisfy the identified scope, requirements, and
- Standards;
• Anticipated costs and benefits;
• Anticipated time frame;
• Market capabilities;
• Community and economic impact.

In addition, the public authority should consider organisational readiness for change, the availability of funding and risk assessment. Opportunities for re-organisation or restructuring should also be considered, even if they do not conform to existing policies and procedures, as these too should be reassessed if benefits can be perceived. The potential to package services or functions differently need to be addressed and there should be a focus on tangible cost reductions or improvements in service.

A3.2 Quantitative analysis techniques

The answers to many of the questions posed in the Business Case will need to be determined by applying appropriate quantitative methods and analytical tools. The actual method chosen to assess costs and benefits will vary according to the nature of the proposal, but the evaluation techniques used most commonly include:

• A cost/benefit analysis;
• A cost/effectiveness analysis;
• Financial analysis.

Additional financial assessments can include net present value, discounted cash flow and rates of return. It is important that public authorities understand the relevance of each option and access sound financial advice if necessary. This is usually available from the principal accounting officer (i.e., chief finance officer) within the public authority or from an accounting professional.

Market research

Market research can be an important element in compiling a Business Case as it can confirm the presence of a perceived need and provide an insight into the most effective commercial method of delivering a public authority's requirement. The type of information that can be gained from market research includes:

• Potential demand for a proposed service;
• Anticipated public response to a proposal;
• Desire of clients to change existing arrangements;
• Impact of population and economic growth;
• The appropriate client base;
• Possible commercial alternatives.

To ensure the integrity of market research, it is advisable to engage professional market research services that will provide a credible, independent assessment.
A3.3 Risk analysis

The Business Case must always address the risks associated with each option and ensure that:

- Risks are identified in terms of likelihood and impact;
- The consequence of adverse contractual performance is considered;
- Strategies are developed to manage identified risks and potential consequences.

**Suggested strategy: Fatal Flaw analysis**

This analysis is designed for early identification of potential ‘show stoppers’ during all stages of the contract purchase process. The aim is to identify only major threats to the viability of the contract. In doing so this allows management to ascertain if the risks can be reduced to an acceptable level or otherwise prevent the process from continuing. There are three stages to conducting the analysis.

- Examine if the purpose and expected outcomes of the contract is consistent with core values.
- Determine all high-level risks that have catastrophic or high consequences, ascertain if improved controls can reduce the likelihood or severity so the risk level is lowered, or whether management is prepared to retain high-level risks.
- Make a case to either continue the process or abandon it if essential criteria cannot be met or key risks cannot be adequately or cost effectively managed.

**The recommendation**

A written recommendation must be prepared to summarise the work done in the Business Case and justify fully the selection of the preferred option. The types of issues addressed should include:

- to what core function the proposal contributes;
- why the proposal is absolutely necessary;
- the alternatives that have been considered;
- the likely cost and the source of funds;
- the benefits it will deliver above existing arrangements (i.e. support for local industry);
- how additional benefits justify any additional costs;
- the nature of critical risks associated with the proposal and management strategies proposed;
- critical success factors to be monitored;
- The consequences of not proceeding.

The completed Business Case will have explored all options and affirmed the preferred method of satisfying the identified need. This information then provides the basis for the procurement-planning phase.
Appendix 4: Plan the purchase

In this section...
Enlisting professional assistance
Creating evaluation committees
Tender selection criteria
Creating an evaluation methodology
Creating an evaluation matrix
Involving the market
Creating public tenders
Types of tendering mechanisms
Period contracts/standing orders
Reducing tendering costs

Appendix 4 is a comprehensive review of purchasing and procurement-related contracts in a Risk Management context.

This section describes how to determine when a procurement plan is required and how to create such a plan. It shows how to identify appropriate selection criteria to include in a tender and how to focus a tender’s scope so that it has the best chance of success.

Appendix 4 investigates various types of tenders and how to reduce costs during the tendering process.

A4.1 Introduction to planning purchases

It is essential that all purchases be planned properly. Good planning involves a structured approach to decide how to conduct a purchase to achieve the best possible outcome. However, any complex, strategic or high value purchase will require a formal procurement plan which might necessitate significant research into tendering strategies, industry development opportunities and Risk Management.

The procurement plan is a documented strategy that helps define and guide the purchasing process. It also assists in identifying appropriate selection criteria for inclusion in tender documentation.

Generally a procurement plan will cover:

- Market research;
- Customer and/or end-user consultation and requirements;
- Social and industry impacts;
- Likely risks and how they will be handled;
- Specification type;
• Procurement strategy (including issues such as whether a single or multi-staged procurement mechanism is required, whether the
• Work is parcelled and if so, how and why, and so on;
• Evaluation criteria including scores and weighting’s and the assessment methodology to be employed;
• The roles and responsibilities of technical, legal and financial specialists and end users (this might require an assessment of any potential conflicts of interest);
• Essential contract design features (for example continuous improvement facilities, gain-sharing, open book and so on);
• The development of an initial contract management strategy including transition arrangements, ongoing performance management measures and disengagement and re-tendering procedures.

The Contract Management Plan should be initiated following approval of the procurement plan. Public authorities must prepare a formal procurement plan in accordance with any directives or guidelines issued by the State Contracts Control Board, the Department of Services, Technology & Administration Public Works Division or the Department of Premier & Cabinet.

The authority, officer or body shall approve procurement plans. Totally exempt public authorities require approval from their accountable officer.

A4.2 Enlisting professional assistance

During the planning stage consideration should be given to any skill limitations within the public authority to enable professional assistance to be sought where needed. As well as professional services available from legal, financial and technical practitioners there are also specialists available in the field of business planning, risk analysis, contract negotiation and due diligence.

Public authorities should also consider appointing a probity auditor for all high risk contracts to ensure the purchasing process is fair and equitable and can withstand public scrutiny or an independent audit. The probity auditor should be independent of the public authority and the potential tender’s and should have a sound understanding of tendering protocol and processes. The probity auditor’s role includes observing the methodology applied in:

• Setting and weighting the evaluation criteria;
• Responding to requests for additional information;
• Evaluating submissions.

The probity auditor should have no voting rights, as this would constitute a conflict of interest.
A4.3 Creating evaluation committees

The composition of the evaluation committee will depend largely on what is being purchased and the associated risks. For simple, routine purchases an evaluation panel of two, comprising the purchasing officer and the end user, might suffice. However, for non-routine, complex requirements it is critical that the evaluation panel has a skill mix that enables the key risks associated with the purchase to be assessed. Specialist financial, technical and legal expertise might be needed. Ideally the proposed contract manager and an end user (who understands the operational implications of the tenders under consideration) should also be included on the panel.

A chairperson responsible for managing the evaluation and decision-making process should be appointed to:

- Ensure all panel members are aware of their responsibilities,
- Including confidentiality;
- Ensure the security of tender documentation;
- Ensure that decisions are made in a timely manner;
- Manage communications between the evaluation panel and other
- Interested parties;
- Ensure that the evaluation panel has access to adequate resources;
- Prepare the final recommendation report.

A4.4 Tender selection criteria

The use of appropriate, well-defined selection criteria enables tenders to focus their submissions, thereby assisting public authorities to assess their relative strengths and weaknesses. The selection criteria should relate to the key risks, critical success factors and major deliverable’s associated with the purchase. These criteria should then form the basis of the key performance indicators (KPIs), against which the performance of the contractor will be measured.

Generally the selection criteria will address the following broad areas:

- Compliance with the contractual terms and conditions;
- The technical merit of the goods or services offered;
- The capability of the tenderer to fulfil the specified requirements, including technical and management competence;
- Financial viability, relevant skills, experience and availability of key personnel;
- Whole of life cycle costs;
- An assessment of the risks or constraints associated with each offer;
- Any wider benefits to the State (for example local employment opportunities).
Specific examples of possible selection criteria are detailed below.

- Whole of life cycle costs, including warranty;
- Maintenance, operating costs, delivery and installation, spare parts, whether prices are firm or variable pricing policies - renegotiation arrangements under contract;
- Viability of project to suppliers, including an assessment of achievability of price offered i.e. is it sustainable over the life of the contract, or does it appear to be too low (as evidenced by the ability of tenderers to validate and explain the price bid);
- Contractual compliance;
- Technical compliance;
- Capacity of the tenderer, Legal scope of powers and authority to enter into contract;
- Previous claims/actions taken against or by the tendering entity i.e. litigious history;
- Corporate structure – simple or complex;
- Complexity of finance/operating structures proposed;
- Key shareholders – reputation/credibility;
- Experience in providing similar services and at the same magnitude;
- Skills and experience of key personnel as evidenced by CVs including proof of membership of professional or industry bodies, independent certifications and qualifications and demonstrated knowledge of what is required;
- Demonstrated track record in delivering the specified service or a related area;
- Demonstrated ability to provide a quality and reliable service;
- Financial viability;
- Ability to finance future capital expenditure/future expansion and so on;
- Ability to absorb losses, if incurred;
- Proposed financing arrangements;
- Financial guarantees from banks, third parties, or, Related parties;
- Financing structure – simple or complex;
- Certainty of financing;
- Level of equity committed to the project;
- Historic performance data including profitability, cash flows, debt equity and net assets;
- Organisational structure;
- Company financial structure;
- Company assessment;
- Demonstrated track record and industry reputation;
• Organisational structure;
• Industrial relations record;
• Quality assurance systems and procedures;
• Willingness to work towards common goals, which might include – open book approach, share of profits, commitment to continuous improvement - observance and promotion of occupational health and safety requirements;
• Technical merit of the product or service fitness for purpose;
• Design and development capability;
• Conformance with standards;
• Compliance with health and safety requirements;
• Adequacy of proposed approach and methodology which might require tenderers to provide transition plans, contingency plans, resource plans, implementation plans and explanation of the linkage of price to approach technical, managerial and physical resources;
• Availability of spares and technical backup support;
• Compatibility with existing systems;
• Durability of product;
• Technical competence;
• Evidence of sound management practices and procedures as evidenced by site references and site visits;
• Ability to meet specified time frames;
• Socio-economic impact net benefit to the state – industrial, regional or social;
• Compliance with broad Government policy objectives;
• Environmental impact;
• Safety impact.

A4.5 Creating an evaluation methodology

At this stage the evaluation panel should also agree on the method of evaluation to be adopted. It is important to recognise that tender outcomes can vary, depending on the method adopted. Selection of the right method is therefore critical.

The choice of evaluation methodology will depend on the value, complexity and risk associated with the purchase. Care should be exercised to ensure that the methodology matches the need. The evaluation of routine goods contracts might involve simply selecting the lowest compliant offer. Such purchases from reputable and established suppliers might not require a formal assessment of capability, whilst major purchases will need to be subject to formal due diligence before acceptance.
A4.6 Creating an evaluation matrix & score range

Evaluation matrix

To assist in the assessment of tenders, it is good practice to develop an evaluation matrix table that details each of the selection criteria and records the scores each tenderer receives against each criterion. It also serves as a useful point of comparison for competing tenders.

Weighting’s reflecting the relative degrees of importance and risk can be allocated to each selection criteria, with those designated as mandatory simply requiring a yes/no response (i.e., technical compliance). In addition, some criteria, such as contractual compliance, are neither mandatory nor weighted (refer to the section on assessing compliance).

Consideration should be given to whether cost is weighted. As a general rule, the non-weighted cost method is suitable for very large, high value and complex purchases as it allows a degree of flexibility and does not reduce the decision-making process to a simple mathematical equation.

Non-weighted cost method

In this method tenders are initially assessed and ranked according to the non-cost selection criteria. Cost details are then considered for each bid and a value judgement is made as to which tender represents the best value for money and has an acceptable level of capability and risk.

In some cases, tenderers might be asked to submit their bids in two envelopes: one containing the non-cost details and the other containing the cost proposal. This allows the technical assessment of capability and risk to be conducted in isolation from costing considerations. Consequently panellists cannot be influenced by cost when assessing non-cost criteria.

Weighted cost method

In this approach, cost is assessed and scored as a criterion alongside the other non-cost factors and assigned weighting.

When assigning cost weighting’s, public authorities should consider the relative importance of cost to the contract. Generally speaking, non-cost factors might be considered more important for complex, high-risk purchases than for simple purchases. For example, if a public authority is buying a simple 'off the shelf' product, price will probably be the prime determinant. However, for the development of software system that is integral to a public authority's operation, factors such as technical merit should assume far greater importance.

It is also important to recognise that there are risks associated with assigning a weight to cost. For example, reducing the value for money decision to a mathematical equation might not deliver the optimal outcome.

Samples of evaluation matrices for different types of evaluation methods are shown at Tables A and B below:
- **Table A** – Evaluation matrix for non-weighted cost method of evaluation

<table>
<thead>
<tr>
<th>Criterion</th>
<th>Weighting</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adequacy of proposed methodology</td>
<td>25%</td>
</tr>
<tr>
<td>Skill and experience of key personnel</td>
<td>25%</td>
</tr>
<tr>
<td>Demonstrated company experience</td>
<td>10%</td>
</tr>
<tr>
<td>Commitment to local industry</td>
<td>15%</td>
</tr>
<tr>
<td>Commitment to a regional presence</td>
<td>15%</td>
</tr>
<tr>
<td>Standard of technology to be applied</td>
<td>10%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100%</strong></td>
</tr>
<tr>
<td>Cost (dollar cost) not weighted</td>
<td></td>
</tr>
<tr>
<td>Contractual compliance Yes/No</td>
<td></td>
</tr>
</tbody>
</table>

- **Table B** – Evaluation matrix for weighted cost method of evaluation

<table>
<thead>
<tr>
<th>Criterion</th>
<th>Weighting</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adequacy of proposed methodology</td>
<td>20%</td>
</tr>
<tr>
<td>Skill and experience of key personnel</td>
<td>20%</td>
</tr>
<tr>
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<td>10%</td>
</tr>
<tr>
<td>Commitment to local industry</td>
<td>10%</td>
</tr>
<tr>
<td>Commitment to a regional presence</td>
<td>10%</td>
</tr>
<tr>
<td>Standard of technology to be applied</td>
<td>10%</td>
</tr>
<tr>
<td>Cost (dollar cost)</td>
<td>20%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100%</strong></td>
</tr>
<tr>
<td>Contractual compliance Yes/No</td>
<td></td>
</tr>
</tbody>
</table>

- **Score range**

  The score range for the selection criteria should also be determined at this stage, with a range of scoring models available. For example, it might be decided to score out of a maximum of five points as follows:
5 = Fully compliant - low risk, satisfies criteria without reservation;
3 = Compliant - medium risk, addresses criteria with some reservation;
1 = Partially compliant - medium to high risk, partially meets criteria;
0 = Fails to comply - high risk, does not meet criteria;

It is important to note that the scoring system relates to each tender’s level of compliance against the criteria, whilst the weighting’s indicate the degree of criticality and risk for each of the criteria.

### A4.7 Involving the market

Purchasing outcomes can be enhanced greatly by actively seeking advice and feedback from the marketplace from the outset, particularly for purchases:

- That are complex, unusual or sensitive;
- Strategic to the public authority’s core business;
- Where the requirement might provide a significant opportunity to foster local business and industry;
- Where it is considered that market input will result in improved tenders.

General market information is available from peak industry bodies, trade journals, trade exhibits, specialist market analysts, and by networking with other procurement bodies.

**More formal approaches to the market might take the following forms:**

**Industry comment on proposed tendering strategies**

This can include pricing options, contract duration, how tenders are packaged and whether single or multi-staged tenders are appropriate.

**Industry comment on draft tender documentation**

For non-routine or complex purchases it might prove beneficial to issue the draft tender to industry for comment before it is formally released to the market. This allows potential suppliers to advise whether the documentation is deficient, onerous or biased and to advise how it might be improved.

**Pre-tender briefing sessions**

These can provide an effective mechanism for ensuring that prospective suppliers are informed of the functional, technical and commercial considerations of a purchase and can provide industry with an opportunity to comment on the proposed procurement strategy.

**Invitation to comment (ITC)**

Generally only undertaken for major projects that are complex and high risk, this involves advising the market publicly of a forthcoming purchase and inviting industry/stakeholder feedback. An ITC can be used at the conceptual stage of a project, when the scope is not well-defined and there is a need to obtain more
information about the product or service and what the market is able to deliver. Information provided by suppliers might then be used to assist with further definition of the project.

This arrangement also provides suppliers with an early and equal opportunity to present information that can influence the direction of the project. Further, it serves as an early notice to the marketplace of a proposed major purchase. This advance notice enables the marketplace to prepare for any subsequent tendering exercise and might encourage potential bidders to combine resources and form a consortium to offer better solutions than could be provided individually.

While this arrangement has benefits both for industry and public authorities, care must be taken to ensure that it is not perceived by the market as a means of acquiring intellectual property without payment.

A4.8 Creating public tenders

Public authorities are required to make every effort to enhance and promote open and effective competition throughout the procurement process. The following example thresholds are designed to maintain a balance between the costs and benefits involved in promoting competition:

- Up to $5,000 (total contract value) – at a minimum, verbal quotations shall be obtained;
- $5000 - $100,000 (total contract value) – at a minimum, written quotations shall be obtained;
- Over $100,000 (total contract value) – at a minimum, a public tender shall be called.

For further information refer to your own policy directive.

Exceptions to the requirement to invite public tenders

Common-use contracts

A common-use contract (CUC) is a type of period contract or standing offer that is administered by the Supply Unit of NSW DPWS. It is an aggregated supply arrangement that enables public authorities and other specified parties to source goods or services that are required routinely.

A public authority shall purchase from a mandatory CUC unless it has an appropriate exemption has been granted approval to purchase outside of the CUC.

Approval to purchase outside a mandatory CUC might be granted if it can be demonstrated that a preferable arrangement to both Government and the community is available outside of the mandatory CUC. This approval might not be granted, however, if it breaches the conditions of the contract to an extent that imposes significant penalties on Government or jeopardises the CUC arrangement.

To ensure that value for money is achieved when seeking offers outside a non-mandatory CUC, public authorities are required to obtain an offer from at least one supplier listed on the CUC. CUC’s can be either mandatory or non-mandatory. For further information, refer to the common-use contracts policy.
Waiving of public tenders

In some instances the requirement to invite public tenders can be waived if it is deemed that there is a valid reason for doing so.

A public authority could seek to waive a public tender or quotation when it can be demonstrated that:

- A bona fide sole source of supply exists, where the market is tested periodically;
- An emergency situation exists that threatens life, property or equipment;
- A public pre-qualification has occurred;
- There is a valid reason for doing so, as deemed appropriate by NSW DPWS.

In addition, a written quotation might be waived if a similar requirement has been sourced recently within the public authority, and it is reasonably expected that the market has not changed.

For a public authority with total exemption, approval to waive public tenders must be granted by their accountable officer or authority. Public authorities with partial exemption must act within their agreed arrangement with DPWS and the State Contracts Control Board.

Selective tenders

- Selective tenders must be called only where pre-qualification of suppliers has occurred, either in relation to a shortlist for a specific tender or a standing list of qualified suppliers.
- Pre-qualification requires public advertising.
- For standing lists, a termination date must be established for the pre-qualification, after which a new requirement must be advertised publicly.

A4.9 Types of tendering mechanisms

A number of tendering mechanisms is available when seeking bids from the market. Depending on the nature of the purchase (type of goods or services, complexity, cost and the characteristics of the market), a decision will have to be made as to whether the tender process should be single or multi-staged. A multi-staged tendering process can be used to gain market knowledge, shortlist qualified tenderers and obtain industry input.

Multi-staged tenders should be considered:

- Where the cost of tendering is high and the market is known to be large;
- For complex purchases that are difficult to specify;
- If industry input is required to refine the statement of requirements.

If there is any uncertainty about the form of documentation required, public authorities should seek assistance from the DPWS and the State Contracts Control Board.
Expression of interest (EOI)

An EOI allows an exploration of the market and an accumulation of ideas, concepts, likely suppliers, indicative costing and so on, culminating in the development of a shortlist. This staged approach enables the gradual development of the statement of requirements in readiness for the formal tender as more becomes known of the requirements and the desired characteristics of the required contractor.

An EOI is invited as the first stage of a two-stage tendering process, with the second stage involving the issue of restricted tenders to shortlisted respondents, based on a specification that has been refined using information from respondents’ submissions. It is vital potential respondents be advised that this is a two-stage tendering procedure that will involve shortlisted respondents being invited to tender, either via a request for proposal (RFP), or a request for tender (RFT).

The EOI is a means of pre-qualifying suppliers based on their technical, managerial and financial capacity. This staged approach is a valid mechanism for reducing the cost of tendering by restricting the issue of formal tenders to those suppliers with demonstrated capacity.

Shortlisting of EOI respondents must be based on the selection criteria specified and it is recommended that the shortlist be approved by the relevant approval authority before the RFP/RFT being issued.

Public authorities must exercise care when framing the specifications/statement of requirements for the tender to ensure they do not breach commercial confidentiality by using the intellectual property submitted by EOI respondents. Such breaches can result in legal action being taken. It is therefore important to ascertain the status of any intellectual property offered in suppliers’ submissions to avoid potential legal action. Where a respondent identifies material subject to copyright, public authorities must seek written permission from suppliers to use that information.

Request for proposal (RFP)

RFPs are used when the requirement can be reasonably well defined in terms of desired outcomes, but where suppliers are encouraged to present flexible and innovative market-based solutions. RFPs are especially suitable for services that require innovative solutions to meet desired outputs and ‘design and build’ type contracts. The intention is to leave scope for flexibility and innovation in situations where there might be a number of viable options.

As RFPs generally result in a variety of solutions being offered, they can prove very difficult to evaluate (given that it might not be possible to compare ‘apples with apples’). Consequently the choice of effective selection criteria is of particular importance for RFPs.

RFPs generally are single-staged procurement mechanisms.

Request for tender (RFT)

An RFT is the most common approach to seeking bids. It is an appropriate mechanism for obtaining bids for clearly defined and specific requirements. RFTs can derive from the evaluation of earlier responses to an EOI or RFP.
A4.10 Period contracts/standing offers

Standing offer arrangements, which are often referred to as period contracts, are continuing offers by a supplier for a pre-determined length of time, usually at a pre-determined price. Standing offers enable a public authority to buy goods or services over a set period on set terms, without the necessity to source the market repeatedly.

It is important to note that no contract is made until a purchase order is placed; with a contract only formed in relation to that order.

While standing offers are not regarded as 'contracts' in the legal sense, all of the usual supply policies and procedures must still be applied.

A4.11 Reducing tendering costs

An open tendering process provides all potential suppliers with an equal opportunity to bid, thereby maximising the establishment of a competitive field and a value for money outcome. Loss of competition can result in higher costs and a reduction in the quality of services offered. It might also impact on the transparency of the process and hence undermine public confidence.

Notwithstanding the above, Government buyers should be mindful that tendering exercises can be costly and resource intensive, both for their public authority and for industry. The following measures should therefore be considered to reduce any unnecessary costs of tendering:

- Using multi-staged tendering where appropriate (i.e. for complex purchases when there are many possible suppliers and tendering costs are high);
- Using standing offers/period contracts where appropriate (i.e. for recurring requirements of goods/services when exact quantities cannot be predicted, thereby negating the need to source the market repeatedly);
- Keeping tender documentation as simple and relevant as possible by ensuring that the level of detail is commensurate with the need. This includes only listing supply policies that are appropriate to the purchase;
- Determining an appropriate duration for contracts and considering the use of optional extension periods for recurring requirements. This provides the flexibility to rollover the contract if it is performing satisfactorily, or to allow it to lapse and return to the market if there are problems;
- Appropriately packaging/bundling tenders to achieve economies of scale and meet market capacity, thereby reducing the frequency of tendering;
- Ensuring the demand for information from tenderers matches the requirement and is not excessive. The effort needed to assess offers will vary, according to the nature of the requirement;
- Ensuring that funds are available and approved for the project before proceeding with processes that require significant resources from suppliers and public authorities (RFPs and RFTs). If there is any uncertainty with respect to funding, prospective tenderers should be notified up front so that they can make a commercial decision as to whether or not they wish to bid.
Appendix 5: Develop the Tender

In this section...
Tender conditions
Contract conditions
Statement of requirements
Vendor response schedule
Selecting a contract type

Appendix 5 provides a framework for preparing tender documents, which are used to source potential contracts. The purpose of this section is to help you prepare tenders which align with your Agency’s expected outcomes and manage the risks involved in procuring goods or services.

A5.1 Introduction

As tender documents are the primary information link between public authorities and potential suppliers, they must be written in a manner that is logical, clear and precise. Sufficient information must be provided to identify clearly the contract objectives, detail the roles and responsibilities of the contracting parties and solicit adequate information to enable assessment of which offer represents best value for money.

Lack of effective documentation will result in differing interpretations of the contractual responsibilities and/or performance of the parties, which can lead to disputes and failure to deliver the contract requirements.

The structure and content of the documentation will vary according to the complexity and value of the purchase. For non-routine purchases it might be helpful to examine documentation previously used by other public authorities for similar requirements. Generally, tender documentation includes the components listed below.

A5.2 Tender conditions

These conditions explain the rules governing the content and submission of tenders, the conduct of the tender process and any relevant Government policies. This section should include the selection criteria developed by the evaluation panel earlier in the contract-planning phase. It should also stipulate that the onus is on tenderers to demonstrate their ability to fulfil the contract by addressing all of the criteria adequately, and that failure to do so might be grounds to eliminate an offer from further consideration.

Any criteria that are deemed mandatory should be identified and the consequence of failing to comply with mandatory criteria should be explained (E.g., that a tender will be excluded from further consideration). It is also good practice for public authorities to disclose the evaluation methodology (including weighting’s) that is to be adopted. However, irrespective of whether or not the evaluation methodology is included in the tender documentation, it should be established and agreed to by all members of the evaluation panel during the contract-planning phase.

There might also be a need to develop special conditions of tendering that are specific to the purchase. These might include clauses pertaining to tender briefings, the provision of referee reports, rights to
inspect premises or facilities, provision of samples and so on. The tender document should be designed to elicit information, which will enable the tenderers performance against the selection criteria to be assessed. For example, tenderers could be required to submit draft transition plans, quality plans, resource plans, project schedules and so on which would enable the panel to assess selection criteria pertaining to the adequacy of the proposed methodology and demonstrated understanding of the task.

**Information that can be requested from tenderers to address key risks**

**Price**

This includes whole of life prices for the goods or services requested. Tenderers should be requested to provide their prices in a prescribed format to enable a meaningful comparison with other submissions.

- A stipulation as to whether prices provided is firm and for what period. Tenderers should also advise the basis on which prices might alter during any optional extension periods.
- Where pricing is complex, tenderers should be required to provide the key assumptions supporting their prices and to break the price into key cost components to enable its sustainability to be assessed.
- Stipulate the mechanism to be adopted for:
  - Reviewing and increasing prices
  - Pricing work modifications or variations
  - Open book access to books and records (relevant where contract is cost plus).
  - A full breakdown of tendered prices to ensure the tenderer understands the scope of work required.
- Financial viability

  - Audited financial statements for the past three years. (Where financial statements are not audited tenderers should be requested to provide management accounts.)
  - Details of any events subsequent to the last set of accounts having an impact on the financial position of the tenderer, or the results of its operations.
  - Details of organisational structure and the entity that will be providing the goods or services, including details of contracted entities/associated companies and details of principal shareholders
  - An overview of the tenderer's principle operations, including key customers and key contracts.
  - Details of any claims/actions against the tenderer.
  - Company history.
  - A feasibility/cash flow analysis demonstrating the viability of the project based on the prices provided, together with the key assumptions underlying the analysis.
Where significant start-up costs/capital costs are required to provide the goods/services requested, details of how these costs are to be funded and, where applicable, the proposed financing structure.

Details of any performance/bank guarantees to be provided.

Level of equity to be committed to the project.

Details of funding for the project.

• Experience

Recent relevant experience in providing the goods/services requested, together with referees and discussion on recent Engagements undertaken.

Skills and experience of key personnel responsible for providing the goods/services, including curriculum vitae’s.

Demonstrated knowledge of the industry/goods/services being requested.

Details and experience of subcontractors to be used and the tasks they would perform.

Details of relevant memberships and qualifications together with documentation supporting the current status of these memberships.

Management team and structure.

• Capacity to deliver

Demonstrated understanding of exactly what is required and how the tenderer intends to provide the goods/services requested;

An outline of the methodology/approach to be adopted;

Any environmental considerations and the strategies to address these;

Procedures/policies to be adopted to ensure that quality goods/services are provided within the stipulated time frame;

Details of insurances/indemnities/ performance guarantees to be taken out;

Proposed mechanisms for monitoring contractual performance;

Details of quality assurance systems and procedures;

Transition plans;

Detailed contingency plans;

Detailed resource plans;

Adequacy of insurance cover;

Customer service charter/plan.
A5.3 Contract conditions

These are the terms and conditions that will apply once the contract is awarded. There are ranges of general (or standard) conditions, which are used as the basis for most public sector contracts. They include conditions relating to termination, default and insurance liabilities.

Public authorities should select general conditions of contract, which are appropriate to the requirements of the purchase. There is a range of general conditions available including:

- The Department of Contract and Management Services' general conditions of contract for the supply of goods, provision of services, engagement of consultants and for minor works;
- The Australian Standards' general conditions of contract for construction, including AS4000 and AS4122;
- The Government Information Technology Contract, which is a standard set of terms and conditions specific to public sector information technology (IT), purchases;
- Many public authorities have also developed general conditions of contract suited to their own needs;
- If a public authority does not have its own general conditions of contract, it is encouraged to use those that have been developed by DPWS.

In addition, special conditions of contract will need to be developed that are specific to the required purchase, such as delivery and payment conditions, financial and performance guarantees, liquidated damages, copyright, confidentiality and arbitration or dispute resolution.

For purchases that are high risk, high value, complex or strategic, public authorities should seek legal advice in the early planning stage, as the contract documentation might need to be developed specifically for the requirement.

The tenderer's level of compliance with terms and conditions is an important factor when assessing tenders. Consequently, it might be beneficial to require tenderers to indicate compliance with contractual conditions on a clause by clause basis, particularly for complex requirements.

A5.4 Statement of requirements

The statement of requirements (SOR) or specification is the vehicle by which a public authority provides tenderers with a comprehensive description of its requirements.

The specifications might be:

- Functional (focus on what is to be achieved, i.e. on outcomes, rather than how it is done);
- Performance-oriented (defines the performance parameters required of a good or service but not the methods used to achieve them);
- Technical (highly prescriptive, usually detailing physical characteristics such as size, capacity, type of materials, tolerances and so on);
• Any combination of the above.

These requirements must be detailed in a manner that is clear, concise, logical, unbiased and accurate. Inadequate definition of requirements might result in:

• Tenders that ultimately will not deliver requirements;

• A wide disparity of tenders being received that cannot be compared on an 'apples with apples' basis;

• Tenderers loading their prices to cover unforeseen contingencies that could and should have been incorporated in the SOR;

• Disputation as a result of differing interpretations of contractual responsibilities and/or performance of the parties;

• The contract manager being unable to measure performance as the defined output is too vague.

Critical success factors, standards of performance and proposed contract management arrangements should be specified. This section should address how the contractor's performance will be assessed under the contract, in the form of key performance indicators that are clear and measurable. Generally these performance indicators should allow the contractor to meet the required outcomes in a manner that is consistent with accepted industry standards, methods and practices.

Outcome-based specifications, which allow an examination of possible solutions and encourage competition in the marketplace, are generally preferred. Detailed technical specifications might, however, still be appropriate on some occasions. In these circumstances relevant Australian or international standards should be used where possible. The SOR should distinguish clearly between mandatory requirements and those that are merely desirable, with tenderers being required to indicate compliance or otherwise on a clause-by-clause basis. There might be times when it is necessary to seek assistance from the private sector in the preparation of the statement of requirements. This creates the potential for a conflict of interest that must be managed by the public authority.

Ideally, the individual/company preparing the statement of requirements should be precluded from tendering for the subsequent tender. In some cases, however, this is not feasible as it would not be commercially viable for a supplier to prepare the specification (thereby forgoing the opportunity to tender for the subsequent body of work) and there is no other available expertise, either in-house or elsewhere in Government. Under these circumstances public authorities must take steps to minimise the potential for allegations of unfair or preferential treatment. You should consider the following steps:

• Distributing the SOR/specification for industry comment before the tender being issued;

• disclosing the involvement of the supplier in the tender documentation to ensure the process is open and transparent;

• Holding a pre-tender briefing to provide all potential tenderers with an opportunity to obtain an equal understanding of the requirement;

• Ensuring that the tender-open period is sufficient to allow other players to familiarise themselves adequately with the requirement.
A5.5 Vendor response schedules

These should bring together all the requirements raised in the previous sections (and make cross-reference to those) and present them in a simple format, preferably tabular. Pro forma questionnaires and other documents for suppliers to indicate their compliance with technical, commercial and contractual requirements and costing summaries should be included, where appropriate.

Care must be taken to ensure that the tender document is integrated so that there is a clear link between the statement of requirements, evaluation criteria and conditions of tendering and conditions of contract.

A5.6 Selecting a contract type

The selection of an appropriate contract type depends on factors such as the nature of the goods or services, any uncertainties involved in contract performance and the extent to which the public authority or contractor is required to assume the risk. Contract types vary based on the degree of responsibility assumed by the contractor and the amount and type of profit incentive offered to meet or exceed specified standards.

A number of factors should be considered when selecting the appropriate contract type, including the:

- Type and complexity of the purchase;
- Administrative costs for both parties;
- Difficulties involved in clearly defining the requirements of the contract;
- Degree to which the public authority is required to provide technical or operational coordination;
- Duration of the contract;
- Volatility of cost inputs (such as materials and wages).

Fixed price

- These contracts require tenderers to bid a total fixed cost for the project. Consequently, the successful tenderer carries all of the risks of price escalation.

- This type of contract is well suited to purchases where all of the requirements are known and are unlikely to change over the period of the contract. Fixed price contracts are generally not suitable for long-term arrangements because of the difficulty for suppliers to estimate costs over the longer term. Using a fixed price contract when the risks are unknown or not readily measurable can result in inflated prices, inadequate competition, poor performance and disputes.

Variable contracts

- These contracts enable contract rates to be varied according to a pre-determined formula or based on specified cost factors.

- Schedule of rates
• These contracts require tenderers to bid a unit cost or hourly rate for the goods or services, rather than a total cost. This type of contract is used for requirements that can be easily defined, but where the quantity is uncertain.

• A schedule of rates is often used for period contracts, where goods or services are required on an 'as and when required basis' over a specified period.

**Cost-reimbursable contracts**

• The contractor is paid for any actual costs incurred plus a management fee that might be a fixed sum or a percentage to cover overheads and profit margin.

• These contracts are used where requirements are difficult to specify, resulting in uncertainty and risk for tenderers in determining their costs. Cost-reimbursable contracts contain little encouragement for contractors to control cost and hence require significant effort in contract management.

**Cost-incentive contracts**

• These types of contracts enable risks pertaining to costs to be shared between the purchaser and the contractor. They enable the contractor to be reimbursed for costs incurred up to a ceiling amount and generally establish a formula whereby the contractor is rewarded for performing at less than target cost or is penalised for exceeding target cost. Consequently, the contractor's profit margin is linked to its ability to control costs.

**Performance-incentive contracts**

• Performance-incentive contracts have a price basis that includes performance goals and a formula for increasing or decreasing the incentive/compensation if the specified performance goals are exceeded or not met. For example, early completion might entitle the contractor to a bonus, while late completion might entitle the purchaser to a price decrease.

**Partnering and alliances**

• Partnering and alliance relationships generally involve joint management arrangements in which both parties to a contract agree to cooperate as openly as possible. This approach is usually adopted in order to deliver strategic gains, such as ongoing improvements in cost and quality development, innovations, and new products or market specialisation.
Appendix 6: Invite and receive offers

In this section...

Advertising tenders
Pre-tender briefings
Tendering period
Receiving tenders
Opening and registering tenders
Recalling tenders

Appendix 6 describes the process of inviting and receiving contract offers through tendering. Basically this section deals with managing a tender bid once your Agency has created.

This Appendix covers the first of four stages of formulating a contract.

1. Inviting and receiving offers.
2. Evaluate offers.
3. Negotiate and apply due diligence.
4. Finalise and award the contract

A6.1 Advertising of tenders

- As a minimum, public tenders must be advertised in a newspaper with State wide circulation. Other suitable advertising mediums include regional and national newspapers, noticeboards, and trade journals, the Internet and direct mail-outs.
- Generally, advertisements should contain:
  - A description of the scope of work;
  - Details of the available documentation;
  - A contact point for further information;
  - Details of the closing date and time;
  - The address to which tenders must be lodged and the method of submission;
  - Details of any pre-tender briefings, if applicable.

A6.2 Pre-tender briefings

- Pre-tender briefings are a useful tool for ensuring equality of information and opportunity, facilitating and promoting local industry involvement, and providing a process for involving industry in the development and refinement of tender specifications.
- Pre-tender briefings should be considered for requirements that:
  - Are complex, unusual or sensitive;
  - Are strategic to a public authority's core business;
Provide an opportunity to foster local business and industry.

- Pre-tender briefings should be scheduled so that there is:
  - Sufficient time for potential tenderers to familiarise themselves with the tender before the briefing session;
  - Adequate time following the session to allow for issues raised to be considered and reflected in the tenders under preparation;
  - Adequate commuting time allowed for overseas, other states and regional attendees, where applicable.
  - Mandatory briefings that might discriminate against suppliers who have difficulty attending at the nominated time should only be used in exceptional circumstances.
  - A register of attendance should be maintained and a record of all questions and answers arising from the briefing session circulated to all attendees. Any amendments or clarification to the tender resulting from the pre-tender briefing should be circulated to all potential tenderers via a formal written addendum.

## A6.3 Tendering period

- The tender should be open for a sufficient period to enable the market to respond effectively. This period will vary depending on the complexity of the requirement. As a general rule tenders of a relatively straightforward nature should be open for at least three weeks, while major or complex requirements should be open for at least six weeks.

- During this period, prospective tenderers will often seek additional information or clarification of the requirement and it is critical to ensure that all prospective tenderers are treated in a fair and equitable manner. Any details provided to one supplier that could materially alter the understanding of the requirement or provide a competitive advantage should therefore be conveyed promptly to all potential tenderers.

- A register should be maintained of all suppliers that have collected or been forwarded a copy of the tender document. This will enable potential tenderers to be advised of any alterations to the tender, via the issue of a formal addendum.

- Potential tenderers should be asked to confirm the receipt of addenda in writing and should be required to acknowledge in their tender submission that allowance has been made for all addendum’s issued.

- Depending on the magnitude and timing of any amendments, it might be necessary to either extend the tender closing time to allow tenderers to review and revise their bids or to reject all tenders open and effective competition, probity and equity will assist in received and recommence the process. The overriding principles of determining whether or not the tender should be re-called. For example, if the amendment could open up the market considerably, tenders should be re-called to a revised specification.
• From time to time, potential tenderers might request an extension to the tender closing time. Only in exceptional circumstances might public authorities assent to such a request; i.e. if it is clear that the original date was inappropriate. This might arise if the market signals that the tendering requirement is more complex than originally anticipated by the public authority (as a result more time is required to prepare valid tenders), or where it can be verified that potential tenderers require more time to obtain quotes from overseas suppliers in order to cost their offer. Should a public authority agree to such a request,

• the tender must be formally extended via the issue of an addendum, which must be forwarded to all potential tenderers.

• Consideration must also be given to the timing of any requests for extension. Sufficient notice must be provided to enable all potential tenderers to benefit from the extension (i.e. it is not appropriate to extend a tender one day before the tender closing time when some bidders might have already lodged their bid). As a general rule, there should be at least five working days between the date of notification of an extension of tender and the original closing date.

### A6.4 Receiving of tenders

• Public authorities, and private sector organisations purchasing on behalf of public authorities, must ensure that all necessary arrangements are made to safeguard the security and confidentiality of tenders, with a secure tender box used to hold offers until the nominated closing time.

• Tenders might usually be lodged by hand, mail, courier or facsimile, unless any of these methods are expressly precluded in the request for tender.

• In some instances, facsimile lodgement might not be appropriate, such as for major tenders requiring comprehensive responses. In these circumstances public authorities might wish to exclude the option for facsimile transmission of offers.

• Tenders should be time and date stamped before being placed in the tender box. As the security of tenders is paramount, tenders should be placed in the tender box immediately following receipt. Tenders should not be removed from the tender box until the box is officially opened on the advertised closing date and time by two officers with delegated responsibilities for that task.

### A6.5 Opening and registering tenders

• Tenders should be opened following the nominated closing time, time and date stamped, and countersigned by two officers with responsibility for that task. It is recommended that all pages containing pricing information be time and date stamped and initialed by these officers as a means of ensuring that pricing information is not revised after tenders have been opened.

• All tenders should be registered and recorded in a tender register. The register should record the tender number, name of the tenderer and the number of responses for each tender.

• Late tenders must not be accepted unless they conform to the criteria for admitting late tenders, which should be stated in the tender document. Generally, the criteria for admittance of late
tenders are confined to mishandling by the public authority's personnel, but it might also include mishandling by an official postal service.

- Tenders submitted by other means should not be considered under the criteria for admittance of late tenders. Late tenders should be stamped 'late tender' as well as being time and date stamped. Late tenders, that do not meet the criteria for admittance of late tenders, should be placed on the tender file with the accompanying envelope and must not be considered further. Tenderers submitting late tenders should be advised promptly, in writing, that their tender was received late and therefore could not be accepted.

- It should be noted that some public authorities, particularly those in the construction area, hold public tender openings and release some information at that time (generally the name of the tenderer and the tendered price).

### A6.6 Recalling tenders

In some circumstances it might be appropriate to re-call or re-invite tenders where:

- No tenders have been received;
- All of the tenders received were non-compliant, either contractually or technically;
- The tenders received cannot be adequately or fairly compared (usually the result of a poorly defined requirement);
- There is evidence of collusion between tenderers;
- The tender was over-specified and prevented open and effective competition;
- Better value might be obtained by re-calling a revised tender.

Before initiating a re-call, public authorities should take into account the significant cost of re-inviting tenders and the potential for criticism from tenderers. Having made the decision, public authorities must formally advise all bidders that tenders have been declined and should also advise whether tenders are to be re-called and the reasons for tenders being declined.
Appendix 7: Create a Contract Management Plan

In this section...

CMP background
Sections to include in a CMP
  Contracting parties
  Contract details
  Contract management

Appendix 7 describes how to create a Contract Management Plan (CMP), which is a brief summary of the purchasing process that led to the contract. Its purpose is to manage contracts once they have begun, provide a background and reference point and guard against knowledge loss through staff re-deployment.

This section is mainly geared towards Contract Managers.

A7.1 Background

The CMP is a brief summary of the purchasing process that led to the contract and references to source documents. Items to be addressed include:

- Reason for the contract;
- Objectives;
- Options considered;
- Analysis undertaken; and,
- Key assumptions.

Although it is highly desirable for those who were closely involved in the contract development to also be responsible for the management of the contract, this is not always possible. The background should therefore be sufficiently comprehensive to serve as a reference guide for this situation and also to guard against loss of knowledge due to staff redeployment.

In addition, the public authority should consider organisational readiness for change, the availability of funding and risk assessment. Opportunities for re-organisation or restructuring should also be considered, even if they do not conform to existing policies and procedures, as these too should be reassessed if benefits can be perceived. The potential to package services or functions differently need to be addressed and there should be a focus on tangible cost reductions or improvements in service.
A7.2 Contracting parties

- Contractor;
- Contractor details including company name, phone/fax numbers, profile of organisation and contact details such as who has the authority to approve changes;
- Client or user;
- Contact details and their involvement and key responsibilities in the contract;
- Contract manager/user;
- Contact details, key responsibilities and full time employee (FTE) allocation. In cases where a separate contract is let for project or contract management, provide details and responsibilities of the management contractor;
- Major stakeholders;
- Contact details and area/reason for interest.
- Intra- and inter-organisational relationships;
- A diagram should be included to show the reporting arrangements for the management of the contract within each organisation and the interaction between the two organisations. The diagram should include notes describing the nature of interaction at each level. For example, at one level interaction might be between the Agency's purchasing officer and the contractor's ordering officer. At the more senior level interaction will be more concerned with contractual issues such as disputes and variations.

A7.3 Contract details

Complete copy of information contained in the contract for each of the headings below:

- Statement of requirements or scope of work;
- Service standards expected;
- Pricing and remuneration arrangements;
- Contract duration – include option or renewal periods;
- Assets/document register;
- Conditions of contract; and,
- Key conditions, such as insurances, warranties and performance /bank guarantees.
A7.4 Contract management

For each of the sections below, include the desired objective and methods / procedures that need to be followed. In some cases these will be included in the contract. A summary of the operational process will include key facts, assumptions, references to and location of source data. An activities checklist should be developed for each section.

- Transition;
- Responsibilities;
- Schedules;
- Relationships;
- Partnering/Alliance Board (as applicable). If the contract is a partnering/alliance arrangement the following details should be shown here:
  - The partnering/alliance charter;
  - Joint management details;
  - Open book arrangements.
- Risks.

Risk assessment and management strategy should include:

- An explanation of each risk;
- How the risk is to be managed;
- What action is to be taken on occurrence of any of the identified risks. (Risks might vary during the contract and the Contract Management Plan (CMP) will need to be updated accordingly).
- Performance monitoring and reporting should include the following:-
  - Reasons for any variation from performance targets;
  - Critical success factors;
  - Key performance indicators;
  - Necessary statistics;
  - Milestones;
  - Monitoring methodology and schedule;
  - Reporting;
  - Finance, budgets and insurances.
  - Payment schedule;
  - Incentive or gain-sharing arrangements;
  - Invoicing and verification procedures;
Include procedures whereby evidence is provided by the contractor of the existence and currency of insurance policies required by the contract.

- Dispute resolution.

Include procedures specified in the contract for the contract manager to monitor and report on the contractor's performance including the severity of any breaches, the need to seek redress and sources specified for redress.

- Contract change/variation.

**Contractual clauses and approval arrangements.**

- Statutory/regulatory requirements.
  
  Occupational Health and Safety;
  Environmental;
  Financial;
  Industrial relations;
  Human resource;
  Commonwealth, State and Local Government licences and approvals.

- Completion/renewal.

Detail arrangements for completion such as certificates, bank guarantees, retention moneys, transition out, handover, return of loan equipment and unused materials, and final performance reports.

- Review and evaluation.

Detail requirements for review and evaluation of the project against objective plans prescribed processes, customer satisfaction and audit requirements. Documentation of lessons learnt and projects completion report requirements.

- Audit.

Detail the requirements for both internal and independent audits and elements of the contract to be audited, including (but not limited to) timeliness of service delivery, satisfaction of Key Performance Indicators (KPIs) and customer satisfaction. For contracts that have alliance or partnering agreements, the audit function might be performed by the nominated representatives from the Agency and the contractor, as specified in the contract and the CMP.

- Project schedule.

A list of and schedule for activities or tasks.

- Document register.

This provides an up-to-date list of all relevant documents (including purpose, current version/amendment status, location and synopsis).

- Future improvements.

Recommendations for improvements to the service or goods, the contract and contract management process.
• Appendices.

Depending upon the type and scope of the contract a variety of Appendices might be required. Examples include:

- Service level agreements;
- Site plans;
- Site diaries;
- Final works schedule;
- Assets register updating; and
- User/client survey questionnaire.
Appendix 8: Example contractor safety process: OHS&R

In this section...

Policies
Procedures
Safety Risk Assessment form
General Health Safety Rules checklist
Safe Work Method statement
Site-specific Safety Management Plan
Contract Safety Implementation Plan

Appendix 8 provides an example of a contractor safety process which should appear in your Agency’s Occupational Health, Safety and Rehabilitation (OHS&R) manual.

This section describes the policies and processes for dealing with contractor OHS&R issues on your Agency’s site. It includes examples of several forms which may be used as part of your Agency’s OHS&R policy.

Appendix 8 is written mainly for your Agency’s OHS&R Officer, however, it is relevant to Contract Managers and executive management since it provides a basis for OHS&R-related Risk Management.

A8.1 Policy

Purpose

The Agency requires all contractors employed by the Agency to comply with Occupational Health and Safety legislation and the Agency safety policy.

This will require:

- Assessment of safety risks at the pre-tender stage
- Selection of contractors on the basis of their safety plan and previous performance
- Ongoing program of monitoring contractor safety performance, and
- Audit and review of contractor’s compliance with safety plan and legislation.

SES/CEO/Senior Managers shall:

- Ensure that this procedure is complied with by any appointed Contract Manager
- Monitor the effectiveness of this procedure, and
- Support the Contract Manager in the implementation, monitoring and review of this activity.

Contract Managers shall:
• Implement this procedure for all contracts they are appointed to as the Contract Manager
• Communicate the intent of this contract to all tenderers, contractors or Agency employees working with contractors, and
• Integrate the contractor safety plan into the overall project plan.
• A8.2 Procedure

All contracts will be let in compliance with the Agency Contracts Policy Document incorporating the following:-

**Contract risk assessment**

A formal Contract Risk Assessment shall be undertaken for each contract. For contracts below (say $100,000) Appendix 1 should be used and retained on the contract file. For larger contracts a more formal approach may be considered necessary.

**Decision on safety approach**

The requirements for the safety section of the tender document will be determined on the basis of the matrix in Figure 1. And Table 1 on the following page:

---

**Figure 1**

---
### Table 1
*Refer Risk Level Rating Matrix: (example in Appendix 2 A2.1 Sample risk levels)

High = High and Substantial Risks, Medium = Significant and Medium; Low = Low

### General contractor site rules

Where the contract is determined to be low risk and below $500,000 the management of contractor safety will emphasise the enforcement of basic contractor rules by the Contract Manager. A copy of these rules is included in Appendix 2.

### Safe work method statement

Where the contract is below $10,000, but is rated as ‘high risk’, the Agency will require a specific Safe Work Method Statement from the contractor for the activity(s) designated as high risk. This should be in the format in the WorkCover guidelines detailed in *Guidelines for writing Safe Work Method Statements in plain English*.

An example is shown in Appendix 3. This Safe Work Method Statement will be used as part of the selection criteria.

### Site-specific safety management plan

For all other contracts the contractor will be required to provide evidence of a Site-specific Safety Management Plan (SSMP). This plan needs to be tailored to the specific project being tendered and evidence of a general Occupational Health Safety and Rehabilitation system will not be acceptable unless applied in writing to the contract being tendered.

The requirements of the Agency Site-specific Safety Management Plan are detailed in Appendix 4. This Appendix should be supplied to the tendering organisations. This SSMP will be used as part of the selection criteria during the tender evaluation process and the final negotiated plan will form part of the contract documentation upon letting the contract.
Project OHS&R management plan and corporate OHS&R management system

These are for large construction contracts above $3 million or highly risk sensitive activities under than amount.

For details of these systems refer to the publication OHS&R Management Systems: Guidelines, from the NSW DPW&S.

Contract Manager- safety implementation plan

To monitor the effectiveness of the contractor in meeting obligations under the General Health and Safety Rules, Safe Work Method Statement and Site-specific Safety Management Plan, the Contract Manager will implement a Safety Implementation Plan.

This plan will require the personal involvement of the Contract Manager. The timing of the requirements under this implementation plan will be part of the Project Plan for larger projects. For smaller projects these reviews will be agreed at the commencement of the project.

On the basis of this Safety Implementation Plan the Contract Manager will review the items below by:

**Induction**

Ensuring that all contract employees have been inducted onto the work site.

This induction must cover the major items in the:

- Safety checklist
- Work method, and
- Contractor safety plan as appropriate.

**Inspection**

Inspecting the contractor work site using an appropriate checklist based on:

- Safety Checklist
- Safe Work Method Statement, and
- Contractor Safety Plan.

**Reported hazards and complaints**

Review hazard reporting, safety non-conformance or complaints to determine if reported hazards and safety complaints have been actioned in an appropriate timescale.

**Accidents and incidents**

Review the contractor accident report book to determine if accidents have been reported as required.

The result of these inquiries will be reported to the contractor using the form in Appendix 5 and will be discussed at the next Contract Review Meeting.
Evidence that the contractor isn’t meeting his/her obligations under this procedure will require further review by the Contract Manager.

**Safety audit and review**

The contractor and the Contract Manager will carry out safety audits. The timing of these audits will be agreed in the Contract Manager Safety Implementation Plan and the SSMP.

The results of these audits will be formally reviewed at least every 12 months and at the end of the contract period.

The review will be retained on file to assist in the selection of this contractor for further work.

The ability of the Agency to require the audit and review must be included in contract terms.

### A8.3 Contractor safety risk assessment form

For small and low-risk contracts only.

**How to use this form**

This form should be used as a checklist only. Further information on hazard identification may be required from the OH&S co-ordinator or WorkCover. Use this checklist when assessing risks associated with hiring on-site contractors. Depending on risks you’ve identified, you may need to adjust the contract and/or working conditions.

**Risk rating**

The rating should be categorised as follows -

- **High (5)**
  - There is a substantial risk of serious injury if the task is not strictly controlled by Specific Procedures.

- **Medium (3 or 4)**
  - There is a risk of serious injury if normal industry standards are not followed.

- **Low (1 or 2)**
  - There is a low risk of injury and this hazard is covered by basic rules.

**Scenario**

This should include the specific issue considered for high risk or the term not applicable (N/A). Where the hazard is rated low or medium, no scenario needs to be filled in.

**Assessment**

Where there is a high rating the contract will be considered high risk.
## Contractor safety risk assessment form

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<thead>
<tr>
<th>Hazards</th>
<th>Scenario</th>
<th>Risk rating 1=low to 5=high</th>
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<tbody>
<tr>
<td><strong>Public safety</strong></td>
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<td>Weather</td>
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A8.4 Contractor general health & safety rules and checklist

This checklist contains the general requirements and conditions that should be maintained at all times by the contractor irrespective of contract size or risk profile. Your Agency may use it as an ongoing checklist to monitor safety performance as well as specifying the contract requirements under which the contractor and employees must abide.

**Note:** The checklist indicates a range of possible hazards. To make the best use of the checklist, modify it to suit the hazard profile of the contracted work.

Your Agency should specify in the contract the various intervals during which you plan to use this checklist. Any unacceptable conditions or activities should be brought to the contractor’s attention.

Determine an appropriate timescale for rectification. Retain this checklist and periodically review previous reports to identify non-conformance trends.

Discuss issues and trends at periodic contract review meetings.

This checklist is from the Victorian Workcover Authority “Managing Contractor Health and Safety Risks Guidelines for Local Government” and can be found on their Internet site.
### General health & safety checklist and safety rules

**Contract name:**  
**Contract description:**  
**Contractor:**  
**Work site location:**  
**Persons completing inspection:**  
**Date:**  

#### Checklist

Add more categories according to activity. ✓ Acceptable, ✗ Not acceptable, N/A

### 1 Health and safety systems

1.1 OH&S policy  
1.2 Accident report book  
1.3 Induction records  
1.4 Rehabilitation policy  
1.5 Workplace inspection records  
1.6 Emergency procedures  
1.7 Training records  
1.8 Safe Work Method Statement if applicable  
1.9 Protective clothing and equipment records

### 2 Housekeeping

2.1 Work areas free from rubbish and obstructions  
2.2 Surfaces safe and suitable  
2.3 Free from slip/trip hazards  
2.4 Floor openings covered  
2.5 Stock/material stored safely  
2.6 Walkways unobstructed and clearly defined  
2.7 Adequate lighting  
2.8 Vision at corners

### 3 Electrical

3.1 No broken plugs, sockets, switches  
3.2 No frayed or defective leads  
3.3 Power tools in good condition  
3.4 No work near exposed live electrical equipment  
3.5 Tools and leads inspected and tagged  
3.6 No strained leads  
3.7 No cable-trip hazards  
3.8 Switches/circuits identified  
3.9 Lock-out procedures/danger tags in place  
3.10 Earth leakage systems used  
3.11 Start/stop switches clearly identified
### 3.12 Switchboards secured

### 4 Mobile plant and equipment

| 4.1 | Plant and equipment in good condition |
| 4.2 | Daily safety inspection procedures/checklists |
| 4.3 | Fault reporting/rectification system used |
| 4.4 | Operators trained and licensed |
| 4.5 | Warning and instructions displayed |
| 4.6 | Warning lights operational if applicable |
| 4.7 | Reversing alarm operational |
| 4.8 | Satisfactory operating practices |
| 4.9 | Fire extinguisher |
| 4.10 | Tyres satisfactory |
| 4.11 | SWL of lifting or carrying equipment displayed |

### 5 Machinery and workbenches

| 5.1 | Adequate work space |
| 5.2 | Clean and tidy |
| 5.3 | Free from excess oil and grease |
| 5.4 | Adequately guarded machinery |
| 5.5 | Warnings or instructions displayed |
| 5.6 | Emergency stops appropriately placed and clearly identifiable |
| 5.7 | Operated safely and correctly |
| 5.8 | Workbenches clear of rubbish |
| 5.9 | Tools in proper place |
| 5.10 | Duckboards or floor mats provided |

### 6 Hazardous substances

| 6.1 | Stored appropriately |
| 6.2 | Containers labelled correctly |
| 6.3 | Adequate ventilation/exhaust systems |
| 6.4 | Protective clothing/equipment available/used |
| 6.5 | Personal hygiene - dermatitis control |
| 6.6 | Waste disposal procedures |
| 6.7 | Material safety data sheets available |
| 6.8 | Chemical handling procedures followed |
| 6.9 | Chemical register developed |
| 6.10 | Appropriate emergency/first aid equipment - shower, eye bath, extinguishers |

### 7 Welding

| 7.1 | Gas bottles securely fixed to trolley |
| 7.2 | Welding fumes well ventilated |
| 7.3 | Fire extinguisher near work area |
| 7.4 | Only flint guns used to light torch |
| 7.5 | Flash back spark arresters fitted |
| 7.6 | Vision screens used for electric welding |
| 7.7 | LPG bottles within 10 year stamp |
7.8 PPE provided and worn
7.9 Hot Work permit system used

### 8 Excavations

<table>
<thead>
<tr>
<th>Section</th>
<th>Requirement</th>
</tr>
</thead>
<tbody>
<tr>
<td>8.1</td>
<td>Shoring in place and in sound condition</td>
</tr>
<tr>
<td>8.2</td>
<td>Excavation well secured</td>
</tr>
<tr>
<td>8.3</td>
<td>Signage displayed and barriers in position</td>
</tr>
<tr>
<td>8.4</td>
<td>Banks battered correctly and spoil away from edge</td>
</tr>
<tr>
<td>8.5</td>
<td>Clear and safe access around excavation</td>
</tr>
<tr>
<td>8.6</td>
<td>Separate access and egress points from excavation</td>
</tr>
<tr>
<td>8.7</td>
<td>Safe work procedure in place</td>
</tr>
</tbody>
</table>

### 9 Preventing falls

<table>
<thead>
<tr>
<th>Section</th>
<th>Requirement</th>
</tr>
</thead>
<tbody>
<tr>
<td>9.1</td>
<td>All work platforms have secure handrails, guarding or fence panels</td>
</tr>
<tr>
<td>9.2</td>
<td>Harness and lanyard or belts provided</td>
</tr>
<tr>
<td>9.3</td>
<td>All floor penetrations covered or barricaded</td>
</tr>
<tr>
<td>9.4</td>
<td>Unsafe areas signposted and fenced</td>
</tr>
<tr>
<td>9.5</td>
<td>Safe work procedure in place</td>
</tr>
</tbody>
</table>

### 10 Stairs, steps and landings

<table>
<thead>
<tr>
<th>Section</th>
<th>Requirement</th>
</tr>
</thead>
<tbody>
<tr>
<td>10.1</td>
<td>No worn or broken steps</td>
</tr>
<tr>
<td>10.2</td>
<td>Handrails in good repair</td>
</tr>
<tr>
<td>10.3</td>
<td>Clear of obstructions</td>
</tr>
<tr>
<td>10.4</td>
<td>Adequate lighting</td>
</tr>
<tr>
<td>10.5</td>
<td>Emergency lighting</td>
</tr>
<tr>
<td>10.6</td>
<td>Non-slip treatments/treads in good condition</td>
</tr>
<tr>
<td>10.7</td>
<td>Kick plates where required</td>
</tr>
<tr>
<td>10.8</td>
<td>Clear of debris and spills</td>
</tr>
<tr>
<td>10.9</td>
<td>Used correctly</td>
</tr>
</tbody>
</table>

### 11 Ladders

<table>
<thead>
<tr>
<th>Section</th>
<th>Requirement</th>
</tr>
</thead>
<tbody>
<tr>
<td>11.1</td>
<td>Ladders in good condition and marked for inspection</td>
</tr>
<tr>
<td>11.2</td>
<td>Ladders not used to support planks for working platforms</td>
</tr>
<tr>
<td>11.3</td>
<td>Correct angle to structure 1:4</td>
</tr>
<tr>
<td>11.4</td>
<td>Extended 1.0 metre above top landing</td>
</tr>
<tr>
<td>11.5</td>
<td>Straight or extension ladders securely fixed at top</td>
</tr>
<tr>
<td>11.6</td>
<td>Metal ladders not used near live exposed electrical equipment</td>
</tr>
</tbody>
</table>

### 12 Personal protection

<table>
<thead>
<tr>
<th>Section</th>
<th>Requirement</th>
</tr>
</thead>
<tbody>
<tr>
<td>12.1</td>
<td>Employees provided with PPE</td>
</tr>
<tr>
<td>12.2</td>
<td>PPE being worn by employees</td>
</tr>
<tr>
<td>12.3</td>
<td>Sunscreen and sunglasses provided for outside work</td>
</tr>
<tr>
<td>12.4</td>
<td>Correct signage at access points</td>
</tr>
</tbody>
</table>

### 13 Manual handling

<table>
<thead>
<tr>
<th>Section</th>
<th>Requirement</th>
</tr>
</thead>
<tbody>
<tr>
<td>13.1</td>
<td>Mechanical aids provided and used</td>
</tr>
<tr>
<td>13.2</td>
<td>Safe work procedures in place where applicable</td>
</tr>
<tr>
<td>13.3</td>
<td>Manual handling risk assessment performed</td>
</tr>
</tbody>
</table>
### Manual handling controls implemented (13.4)

#### Workplace ergonomics (14)

- **14.1** Workstation and seating design acceptable
- **14.2** Ergonomic factors considered in work layout and task design
- **14.3** Use of excessive force and repetitive movements minimised
- **14.4** Appropriate training provided

#### Material storage (15)

- **15.1** Stacks stable
- **15.2** Heights correct
- **15.3** Sufficient space for moving stock
- **15.4** Material stored in racks/bins
- **15.5** Shelves free of rubbish
- **15.6** Floors around stacks and racks clear
- **15.7** Drums checked
- **15.8** Pallets in good repair
- **15.9** Heavier items stored low
- **15.10** No danger of falling objects
- **15.11** No sharp edges
- **15.12** Safe means of accessing high shelves
- **15.13** Racks clear of lights/sprinklers

#### Confined spaces (16)

- **16.1** Risk assessment undertaken
- **16.2** Communication and rescue plan in place
- **16.3** Safety equipment in good working condition
- **16.4** Suitable training provided to employees
- **16.5** Confined Space permit used

#### Lasers (17)

- **17.1** Operator has laser operator licence
- **17.2** Signage displayed
- **17.3** Laser not used in a manner to endanger other persons

#### Demolition (18)

- **18.1** Risk assessment undertaken in advance
- **18.2** Access prevented to demolition area
- **18.3** Overhead protection in place
- **18.4** Protection of general public
- **18.5** Safe work procedure in place

#### Public protection (19)

- **19.1** Appropriate barricades, fencing, hoarding, gantry secure and in place
- **19.2** Signage in place
- **19.3** Suitable lighting for public access
- **19.4** Footpaths clean and free from debris
- **19.5** Dust and noise controls in place
| 19.6 | Site access controlled |
| 19.7 | Traffic control procedures in place |
| **20 Amenities** | |
| 20.1 | Washrooms clean |
| 20.2 | Toilets clean |
| 20.3 | Lockers clean |
| 20.4 | Meal rooms clean and tidy |
| 20.5 | Rubbish bins available - covered |
| **21 First aid** | |
| 21.1 | Cabinets and contents clean and orderly |
| 21.2 | Stocks meet requirements |
| 21.3 | First aiders names displayed |
| 21.4 | First aiders location and phone numbers |
| 21.5 | Qualified first aider(s) |
| 21.6 | Record of treatment and of supplies dispensed |
| **22 Lighting** | |
| 22.1 | Adequate and free from glare |
| 22.2 | Lighting clean and efficient |
| 22.3 | Windows clean |
| 22.4 | No flickering or inoperable lights |
| 22.5 | Emergency lighting system |
| **23 Fire control** | |
| 23.1 | Extinguishers in place |
| 23.2 | Fire fighting equipment serviced/tagged |
| 23.3 | Appropriate signing of extinguishers |
| 23.4 | Extinguishers appropriate to hazard |
| 23.5 | Emergency exit signage |
| 23.6 | Exit doors easily opened from inside |
| 23.7 | Exit path ways clear of obstruction |
| 23.8 | Alarm/communication system - adequate |
| 23.9 | Smoking/naked flame restrictions observed |
| 23.10 | Minimum quantities of flammables at Workstation |
| 23.11 | Flammable storage procedures |
| 23.12 | Emergency personnel identified and trained |
| 23.13 | Emergency procedures documented - issued |
| 23.14 | Emergency telephone numbers displayed |
| 23.15 | Alarms tested |
| 23.16 | Trial evacuations conducted |
| 23.17 | Personnel trained in use of fire fighting equipment |
A8.5 Safe work method statement

The Safe Work Method Statement breaks down work processes (or activities) into discrete steps.

Use this form to consider each step in terms of possible hazards and required controls.

Part 2 of the form details the contractor’s competence, references and other relevant information.

Use the Safe Work Method Statement to manage on-site work risks and contractor competence.

**Safe work method statement (Part 1)**

<table>
<thead>
<tr>
<th>Procedure (in steps)</th>
<th>Possible hazards</th>
<th>Safety controls</th>
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<tbody>
<tr>
<td>1</td>
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</tbody>
</table>

Contractor: ..................................................................................... Number: ...........................................
Project: ................................................................................................................... Date: ...........................
Job: ....................................................... Area: ...........................................................
Accepted? Yes / No
### Safe work method statement (Part 2)

<table>
<thead>
<tr>
<th>Contractor’s qualifications and experience</th>
<th>Training required to complete work (if any)</th>
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<thead>
<tr>
<th>Duties and responsibilities</th>
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<table>
<thead>
<tr>
<th>Engineering details/certificates/Workcover approvals</th>
<th>Codes of practice, legislation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
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<thead>
<tr>
<th>Plant/equipment</th>
<th>Maintenance checks</th>
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<tbody>
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</table>

Read and signed by all employees on site: .................................................................

............................................................................................................................

........................................................................................................................................
A8.6 Criteria and checklist for site-specific safety management plan

This section provides a broad description of the criteria that the contractor must include in a Site-specific Safety Management Plan.

Your Agency may use this plan’s format as a basis for monitoring, evaluating or auditing the contractor.
Criteria and checklist for contractor safety plan

<table>
<thead>
<tr>
<th>Policy</th>
<th>Criteria</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Responsibility</td>
<td>Responsibilities of Project Manager and major management positions include safety of employees</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Occupational Health and Safety available from in-house or external consultants</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Responsibility for specific procedures is clear</td>
<td></td>
</tr>
<tr>
<td>2 Project risk assessment</td>
<td>There is a clear and written risk assessment of all tasks required in the project</td>
<td></td>
</tr>
<tr>
<td></td>
<td>All activities involving a high risk of personal injury have appropriate written procedures. These can include Safe Work Method Statement, Q.A.-style procedures or Job Safety Analysis of specific activities</td>
<td></td>
</tr>
<tr>
<td></td>
<td>The contractor must demonstrate an understanding of Occupational Health and Safety compliance issues relating to the contract</td>
<td></td>
</tr>
<tr>
<td></td>
<td>For project activity involving changes to the contract activities as the work progresses the contractor demonstrates an ongoing risk assessment program to identify risks</td>
<td></td>
</tr>
<tr>
<td>3. Hazardous materials</td>
<td>The contractor has procedures to identify, assess and control all hazardous materials brought onto the site</td>
<td></td>
</tr>
<tr>
<td>4 Plant and equipment inspection</td>
<td>If the contractor uses vehicles, plant or equipment as part of the contract they should demonstrate a system of inspection of the vehicle, plant and equipment</td>
<td></td>
</tr>
<tr>
<td>5 Consultation and communication</td>
<td>The contractor must demonstrate procedures for consultation with staff specifically aimed at improving awareness of safety issues. These may include safety committees or ‘tool box’ meetings</td>
<td></td>
</tr>
<tr>
<td></td>
<td>The contractor must show a system that ensures that current safety procedures are available to all employees</td>
<td></td>
</tr>
<tr>
<td>6 Emergency response</td>
<td>The contractor must demonstrate that emergency procedures exist for the contract. These procedures must ensure that the Agency is notified of incidents</td>
<td></td>
</tr>
<tr>
<td>7 Subcontractor plan</td>
<td>The contractor must have written procedures for the recruitment, control and monitoring of subcontractors unless they intend to manage subcontractors as their own employees for the purpose of this contract</td>
<td></td>
</tr>
<tr>
<td>8 Welfare provisions</td>
<td>The contractor must have reviewed welfare facilities required by his employees and have made provision for its inclusion in the project start-up</td>
<td></td>
</tr>
<tr>
<td>Policy</td>
<td>Criteria</td>
<td>Score</td>
</tr>
<tr>
<td>-------------------------------</td>
<td>------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
<td>-------</td>
</tr>
<tr>
<td><strong>9 Safety promotion</strong></td>
<td>The contractor must demonstrate that safety is promoted as a major aim of the contract. Examples may be posters, incentive schemes, safety notice boards or other initiatives</td>
<td></td>
</tr>
</tbody>
</table>
| **10 Accident/incident reporting** | The contractor must have a written system for the reporting of all accidents and significant incidents  
The contractor must demonstrate that a system exists to meet legal requirements regarding reporting of accidents to WorkCover                                                                                                                                                                                                                 |       |
| **11 First aid**              | The contractor has procedures to identify, assess and control all hazardous materials brought onto the site                                                                                                                                                                                                                                                                                    |       |
| **12 Training**               | The contractor must demonstrate that all employees have the necessary training, experience and relevant licences to perform the work safely  
The contractor in particular must demonstrate that appropriate Occupational Health and Safety training has been provided for:  
• Managers  
• Supervisors  
• Safety Committee members  
The contractor must demonstrate how safety is to be covered as part of the contract induction training                                                                                                                                                                                                                                               |       |
| **13 Inspection/audit**       | Procedures must be available to ensure that the work site is inspected regularly  
The contractor must demonstrate a suitable level of auditing of his safety plan to ensure that work site activities conform to the SSMP  
The contractor must ensure that procedures exist to action any recommendations or non-conformance's raised by the audits or inspection within a realistic period                                                                                                                                                                                                           |       |
| **14 Review**                 | The contractor must have a system to review the effectiveness of the safety plan and provide written details of this review process at the following periods:  
• The end of the contract  
• Every 12 months from the start of the project                                                                                                                                                                                                                                                                               |       |
| **15 Specific Agency requirements** | Specific issues identified in the contract documentation or identified subsequently to the contractor must be covered by specific procedures                                                                                                                                                                                                                                           |       |
# A8.7 Contract safety implementation plan form

## Contract safety implementation plan

<table>
<thead>
<tr>
<th>Contractor:</th>
<th>...............................................................................................................................................</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contract description:</td>
<td>..........................................................................................................................................</td>
</tr>
<tr>
<td>Contract name:</td>
<td>........................................................................................................... Date: ...................................</td>
</tr>
<tr>
<td>Work site location:</td>
<td>............................................................ Contract manager: ...........................................</td>
</tr>
</tbody>
</table>

### Timing review

| 1 Induction training | ..........Weeks |
| 2 Safety inspection | ..........Weeks |
| 3 Reported hazards | ..........Weeks |
| 4. Accidents/incidents | ..........Weeks |

### Results of review

| 1 Induction training | Acceptable? .................................... |
| 2 Safety inspection | Acceptable? .................................... |
| 3 Reported hazards | Acceptable? .................................... |
| 4. Accident/incident reporting | Acceptable? .................................... |
Appendix 9: Sample contracting risks

A9.1 Strategic risks

Generally this means that the contracting activity might not fit well with an Agency’s main goals, culture or work practices. The detrimental impact on the organisation might be significant and manifest in ways that could be broad, not easily visible and sometimes subtle.

There is a danger that the required contract outcomes fail to reflect the integrated needs of the organisation even if the contract itself meets contract performance measures. The following are just some risks that could fall into this category:

- Failure to integrate out-sourced activities;
- Loss of Agency knowledge;
- Disruption from outsourcing strategy;
- Failure of contractor to supply a ‘critical’ service;
- Excessive assumption of commercial risks.

Failure to integrate out-sourced activities (decline in ‘value chain’)

All activities conducted by an Agency, whether they are ‘in-house’ or out-sourced, need to be integrated and coordinated. This increases the likelihood of Agencies meeting strategic and operational objectives. The danger with having many out-sourced contractors is that they are unlikely to have the same value systems, culture and objectives.

The result can be tension between Agency employees and contractors, loss of productivity and fall in staff morale. Ultimately this will adversely impact users of Agency services because of a failure of the ‘value chain’ of the organisation.
Possible controls:

- Compatibility assessment
- Contractor evaluation and tender processes for long-term contracts in operational activities could include an assessment of contractor compatibility with Agency objectives and culture. This could include a compatibility assessment with ‘the way we do things around here’ and how and where the Agency intends to make changes in the future.
- Treat key contractors as a stakeholder
- Include key contractors as stakeholders in the management of the contracted operations. This means that those contractors are included in the decision-making process. This might reduce the likelihood of them being over-looked, not being made aware of changes in the organisation that might impact on themselves, or of misunderstanding the issues and expectations of the Agency.
- Loss of Agency knowledge
- There is a danger with outsourcing of losing important knowledge that was once previously held by Agency staff and reflected in the Agencies processes and procedures. Independent contractors might contractually have the right to keep their own techniques and processes confidential. In essence, a situation can occur where no-one person in the Agency knows how critical processes in the organisation work.
- This highlights the problem when key contractors leave- leaving a void of important knowledge.
- Possible controls
- Agencies need to identify and evaluate the potential impact of losses in key knowledge areas. The result might be a decision not to out-source or otherwise create information-recording processes for retaining valuable history and operational processes.
- Disruption from outsourcing strategy
- An inappropriate approach to outsourcing services could cause resentment by staff, industrial disputation and loss of competent staff because of a continuous climate of uncertainty or unnecessary changes.
- There are two general approaches to outsourcing. One is the ‘clean break approach’ and the other the ‘phased approach’. The ‘clean break approach’ involves re-deployment or redundancy of staff. The ‘phased approach’ involves negotiation with the proposed contractor for them to employ selected existing Agency staff and determine their terms of employment.
- Possible controls
- The ‘clean break approach’ might be preferable if a timely and cost effective delivery of service is required. Alternatively, a ‘phased approach’ might be appropriate if the skills and experience of Agency staff is essential to a successful outcome, or the likelihood of industrial disputation is high. Where possible, the outsourcing strategy could include a ‘pilot’ of the chosen method at one location.
- Failure of contractor to supply a ‘critical’ service
- This is a major risk. Agencies need to identify contracted critical processes and activities. If the contractor failed to supply the Agency the result could be severe disruption, increased costs or
create significant hazards or dangers. The objective is to ensure, or improve, the likelihood of continuity of Agency operations.

- Example:
- The majority of metropolitan public hospitals contract to a single linen service. The service suddenly stops because of a severe fire at the contractor’s only factory. The hospital system is thrown into chaos since there is insufficient capacity with other suppliers to meet requirements at such short notice.
- Other examples of contracted critical activities could include activities such as energy supplies and installations, computer networks and transport services.

Comment

Contingency issues must be considered before contracting and could form part of the contracting strategy. The cost of implementing a business continuity plan (BCP) after the contract is already in place could give a sub optimal result. The cost of doing so might eliminate the original expected advantage of the contract over the alternatives.

Possible controls

- Require the contractor to provide an agreed contingency plan.
- Agencies could consider whether the contractual performance criteria should include a requirement for the contractor to submit a business continuity plan to protect their critical business processes from the effects of major failures or disasters.
- Agency to establish their own contingency plan.
- If this is not feasible, the strategy could, for example, be to contract with several suppliers who guarantee an ability to increase service capacity.

Excessive assumption of commercial risk

An example is where a Government Agency enters into a contract with a private sector provider to operate a service for public use. The contractor fails to make a commercial success of the required service. As a consequence the Agency is obliged to undertake one or more of the following:

- Take over and continue to run a loss-making service because the contract provided the contractor with an option to discontinue at a pre-arranged exit price. Alternatively, once the facility is built, the Government for various reasons chooses to continue the service.
- The Agency provides non-refundable financial assistance to the contractor in order to meet a pre-arranged guaranteed return to the contractor.
- The Agency is called to meet a guarantee given to the contractor’s finance providers.
- This risk is more likely to occur for large infrastructure projects but has been known to occur for small community projects. Typical areas where these contracts might occur are in partnerships or joint ventures with private sector organisations or in large ‘BOOT’ (Build, Own, Operate and Transfer) projects.
In the case of large infrastructure projects the losses involved can be at a catastrophic level. In some cases Agencies could inherit a business in which they have no expertise or experience. An example could be taking over the operation of a public parking complex situated on crown or Agency land because of the failure of a private sector organisation in the same activity.

Often the intention behind these contracts with the private sector is to provide public infrastructure or services without using scarce public funds and to control public sector debt. However, if the contract allows the contractor/operator an ‘easy exit’, or for the Government to cover the greater part of a lost investment, then the very opposite outcome can arise. In essence a contingent liability becomes a direct liability. This is particularly the case if the contract includes a guarantee of a contractor’s loan principal and accumulated penalty interest charges.

Possible controls:

- Complete a Full Project Feasibility Study undertaken by experts in the industry;
- Project evaluation by the Agency needs to be just as rigorous for private sector run services, utilities or infrastructure. It needs to be done at the conceptual stage and not after the contract is finalised. Any privately owned, operated or funded public service that in some way is supported by Government needs to ask ‘would we want to continue the operation if the project failed’. A ‘no’ answer might indicate that the support arrangement should not proceed;
- Establish a limit of support according to normal commercial practice;
- Once in-principle support is recommended by a feasibility study and the level of support could be limited to what is reasonably expected in the commercial sector for that particular activity. For example, if it is normal practice in the industry for a private sector organisation to inject its own capital for at least 40 per cent of the total investment, then the Government might question a request to underwrite any investment for an amount of over 60 per cent of the total project investment.

A9.2 Dealing with incorrect contracting decisions

There are three general risk areas:

- Contracts that meet all contract terms and conditions but ‘fail’ to meet key organisational objectives or meet public expectations
- Failure to contract when a contract was required, and
- Establishing a contract without proper authority.

Example risks are listed and explained below:

- Failure to achieve expected benefits;
- Reduction in quality performance;
- Failure to limit costs,(or maintain income levels);
- Void contract;
• Unauthorised contract.

**Failure to achieve expected benefits (although contractor meets requirements)**

A contractor might meet all the performance criteria of a contract but cannot be held responsible for expected benefits or additional costs outside contract specifications—such as expected usage by the public. While this risk could also apply to works that are undertaken by with an Agency’s own resources, the important difference is that with contractors it is likely that any call by the Agency to suspend or terminate the contract will lead to considerable compensatory costs to the contractor.

The fundamental cause of this risk is inadequate cost/benefit evaluation in the planning stage of the contract. Inadequate cost/benefit analysis could be sub-divided into three possible causes:

- Overstatement of the benefit;
- Understatement of the benefit; and
- Under-estimation of total costs.

If the benefits to the public are overvalued, the result could be a major waste of resources (e.g., a ‘white elephant’). It might be the purchase of equipment or construction of infrastructure that is far larger or more sophisticated than required. The consequence of this is not only the waste but also the opportunity cost of foregoing resources to areas where a public need is high.

If the benefits are undervalued, the outcome of a contracted service might be that public needs are not be satisfied or a form of rationing might be required.

Finally, underestimating total cost impacts is possibly, along with errors in scope, the most common risk in contracting. Contracting out services might not reduce costs, improve outcomes, or reduce the level of risk even when all parties to the contract perform their obligations. This has been acknowledged at the Federal level by the Ombudsman, and has applicability to all levels of Government:

‘In the public sector the imperative of reducing costs has not translated itself into cost competitiveness or better services. Rather, it has resulted in various ways to ration services’1

The total costs include the direct, indirect, loss of quality and long-term costs in the post-contract period. An example of total costs could include:

- Fixed price of the contract;
- ‘Cost plus’ estimates, (if applicable);
- Allowances for contract variations;
- Other contingency costs;
- Cost of obtaining expert opinion and project management services;
- Cost of establishing, reviewing and re-drafting tenders;
- (For sale contracts) the cost of preparing the asset in readiness for sale;

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1 Commonwealth Ombudsman (Ms Phillipa Smith) address to Public Service Commission (16 October 1995)

‘Identity Crisis and the Federal Public Servant: Living Up to Tougher Duties of Care in the 1990’s)
• Administration, transaction, legal, financing, and insurance (or risk premium) costs;
• Cost of monitoring the performance of the contractor during the works period;
• Ongoing post contract costs such as training, repairs, maintenance and monitoring.

The total net cost (income) could be ‘net’ of any income (costs). For example, for purchases, this might include estimated resale/scrap value.

For high value and long term contracts (typically, over two years in length) contract costs might also need to be calculated on a Net Present Value (NPV) basis. This accounts for the time value of receipts and payments. It also allows comparison of options so that they can be ranked according to the best return at any given risk level.

Example 1 (Outsourcing)

An Agency decides to out-source its information technology requirements including provision of leased hardware, maintaining existing network system and provision of ‘help desk’ service.

Estimates of ‘savings’ provided by the Agency indicate that a saving of more than $500,000 is expected over three years after the cost of retrenchments, existing contract commitments and overhead savings are all taken into consideration. Performance requirements are reflected in a service level agreement that forms part of the contract and are also for a three-year term.

Users of the hardware and software systems have escalating problems with down-time, rework of lost data, file corruption, failure of email transfers, and delays in service, repairs, and obtaining PC’s for new staff. The service level agreement requires that the contracting company responds to calls within twelve hours of a booked call and responds to the problem within a ‘reasonable period of time’. Each booked service call costs the Agency a fixed amount on top of the fixed contract sum. The replacement cost of stolen or damaged PC’s is calculated at ‘end of lease values’ including all interest charges.

There is no accurate measurement of the impact of the IT difficulties on lost productivity and delays to servicing the Agencies client base. The contractor is unable to fix staff problems in a timely matter but this is overlooked by meeting contract conditions – particularly by making a ‘response’ within the required time and re-scheduling the ‘fix’ until a future date. The turnover of staff working for the contractor is high which adds to inadequate service delivery.

At the end of the three years, the Agency is commended for achieving the target cost reduction. The contractor is known to have made good profits by keeping its staff levels low and due to the high-level of service calls adding considerable additional income. However, overall real costs to the Agency actually increase largely due to the impact of loss productively and the high replacement cost of PCs compared to current market conditions.

Example 2 (Sale of major asset)

An Agency seeks to sell surplus and unused land with redundant buildings on the site. An offer of $500,000 is accepted for the land provided it is cleared and levelled by the Agency. The Agency subsequently finds out that the lowest quote for land clearance, which includes to demolish,
excavate, transport and dump the waste at an approved waste depot, is almost the same cost as the offer. The Agency is bound to sell the property for no real benefit.

The main problem is that the full cost of the contract process was never measured and evaluated. In the first example, there was no effective assessment of the impact of contract terms and performance indicators on productivity and customer service. In the second instance, the cost of clearing was not evaluated before the sale contract.

Possible controls

- In contracting, it is imperative to make a prior assessment of all the practical options including the benefits and costs of each option.
- In order to support a reliable evaluation of overall outcomes against objectives, the contract process should be monitored and reported by persons’ outside the authority and influence of those who recommended the contract and contractor.
- Agencies need to understand the process of full 'life-cycle’ costing if they are to successfully evaluate the true cost of outsourcing its services.

Reduction in quality performance

A contract relationship might be inappropriate where performance is largely based on qualitative aspects that are difficult or impossible to specify compared to quantitative requirements. Experience suggests that this is particularly applicable for contracting of work requiring ‘human’ elements such as in human resource management and case management. Another example is contracting out services directly to welfare or community service recipients who require more patience and additional time than a commercial operation might want to provide.

If tender and contract terms fail to specify qualitative requirements using clear operating criteria then contractors cannot be held responsible for inadequate qualitative outcomes. Situations could occur where the contractor meets measurable and clear standards and has no obligation to adhere to vague or non-existent quality standards. The result is that the contractor achieves contractual rather than operational performance requirements. In these cases, it might be more appropriate to perform such activities with internal resources.

Consequences could include Agencies being ‘locked’ into poorly performing work, disputation, consistent complaints from the community and the Agency could be required to paying out long-term contracts.

There are four basic questions that require an adequate answer in formulating the contract conditions:

- What is required from the contractor?
- This must match clear Agency operational performance objectives.
- What could go wrong by the contractor? For example, if the cleaning contractor does not perform to expectations.

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2 For further explanation, see the Australian Standard on AS/NZS 4536: 1999 Life Cycle Costing- An application guide.
• Is it possible to identify a breach? For example, what does it mean ‘to the highest professional standard’, or ‘when a failure to do so is identified on a consistent basis’?

• What contractual remedies are suitable if a breach occurs? If the only remedy is damages, then an Agency would need to prove that costs were incurred or income was lost as a result of the breach. Unlike the private sector, proving damages can be very difficult in a public sector Agency.

• Termination might not be an appropriate outcome since the Agency might be left ‘high and dry’ and without a critical service being performed.

Possible controls

• There is a need to establish full and explicit criteria of what is expected so that any failure to do so will be identified and can trigger an appropriate remedy. This is not always easy but must be done. Otherwise contracting might not be the best option.

• Criteria needs to be substantially measurable, otherwise a breach of contract might be effectively unenforceable. In such circumstances, an Agency can run the risk that a contractor knows that a contract lacks ‘teeth’ and can therefore be able to shirk their responsibilities or act opportunistically.

• Entering into contracts might be inappropriate because contracts might not be able to enforce adherence to codes of conduct (other than requiring termination), or if the cost of monitoring and enforcement is impractical or prohibitive.

• Where a service level agreement has requirements or expectations that are different to the previous ways of doing things, the performance criteria should be very specific about performance activities that are important. There should not be an assumption that things will change simply because there is now a SLA in place.

The converse to the preceding discussion can also apply. The majority of activities that Agencies undertake do not require contractual arrangements. However, there are instances when a contract produces a better net outcome and reduces risk, albeit at a cost to do so.

Failure to limit costs, (or maintain income levels)

This risk has particular application to situations where three aspects exist:

• Large dollar amounts are involved;

• Costs (or income) are subject to significant market fluctuations; and

• The costs (or income) occur irregularly (i.e., they are not a yearly occurrence).

In the public sector environment, the management of costs is more important.

Typically this risk could arise from large one-off contracts for purchases or sales, or where ‘rise and fall’ clauses allow the Agency to assume price risk in construction or period contracts.

Example: Foreign exchange loss

An Agency requires a major capital purchase of a highly technical item of equipment that can only be sourced from an overseas supplier. The item is not a regular purchase and will have a large impact on the capital expenditure program compared
to normal years. A budget allocation is approved for AUD10 million based on current exchange rates, which has been stable for some years.

Payment is in US dollars and payable on delivery expected in six months. By the time of delivery the AUD had depreciated against the USD by 10 percent. As a result, the cost of the equipment increased by AUD1 million. This can only be sourced from recurrent budget income, and consequently the Agency had to reduce allocations to other areas such as the maintenance and OH&S Risk Management program.

Comment

In this scenario the purchasing strategy failed because a decision-maker considered that the recent history of stable exchange rates is a good guide to the future. One option would to enter into a foreign exchange contract (or some other hedging mechanism) in the financial market to protect the AUD equivalent of the debt owed in the underlying commercial contract. An alternative arrangement would be to contract with the supplier in AUD rather than foreign currency.

Void contract

If a contract is considered void it means that a contract was never legally formed. An Agency could either find it had no power to contract in a certain area or exceeded its capacity to contract.

Examples of circumstances that may lead to a void contract include the following:

- An invalid decision, such as one made by an unauthorised officer. (An exception is the principle of 'apparent authority', see 13.1.5 Unauthorised Contract).
- where there was no intention to create a legal relationship; and,
- If there is a ‘mismatch’ between the offer and acceptance.

The key potential adverse consequences could be:

- Payment of restitutionary claims to another party (i.e., to restore to a pre-existing position); or,
- Damages for financial consequential loss, or ‘nervous shock’, to a client or third party, or
- Failure to meet the contracting objective (i.e., to purchase, sell, undertake a project or obtain valid consent).

When Agencies acts ‘beyond power’ (in legal Latin referred to as ‘ultra vires’) there is a potential for contract decisions to be challenged in courts, particularly for Agencies that are not State owned corporations.3

If an Agency needed to enforce contract terms such as passing title to property, claiming damages or enforcing a debt that was overdue- the normal remedies could be ineffective. The result could have a devastating impact on costs that have already been incurred by the Agency but which cannot be recovered.

In situations where contractors are able to receive restitutionary payment to cover labour and material costs already expended by them, the amount is based on the fair market rate.

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3 In NSW, ‘ultra vires’ has been abolished for State owned corporations under the State Owned Corporations Act 1989 (NSW) s 20zc.
Example 1: Conditional community grant

An Agency issues a grant to a community service provider to undertake a valuable community service. The grant’s written conditions specify the purpose and method in which moneys are to be spent. The community service provider uses the money for another purpose, outside that of the authority given to the Agency. In attempting to recover the grant, the Agency finds that at law, the nature of the agreement was that it was actually a ‘gift with conditions’ rather than a contract because the subject matter is very different from normal commercial agreements. Consequently the remedies and rights available under the contract, now known to be void, could not be enforced and therefore repayment of the grant cannot be enforced.

Example 2: Failure to obtain valid consent

A woman with little understanding of English is advised through her son that her doctor recommended the need for an operation. The doctor follows hospital procedure and arranges for a contracted ‘interpreter to explain the operation and potential risks before obtaining a written consent from the patient’. The operation is undertaken but later the woman and her husband are outraged that the surgery took place since the particular operation was against their religious and cultural beliefs. A court finds the hospital liable for their shock because the interpreter failed to properly explain the full implications of the operation. An important contributing factor was the hospital used a lower grade interpreter who was not an accredited expert in the regional dialect in which the woman spoke. The consent, and therefore the contract, is deemed void.

Possible controls

- Particular care is required in ensuring that the offer/acceptance process is clear and unambiguous and attention is paid to ensuring the proper authority or competency of guardians and interpreters;
- Agreements could be concluded in a deed under seal for large, complex or ‘non commercial’ contracts to ensure that there is an intention to create legal relations;
- Care must be taken with agreements between an Agency and other Agencies or public authorities, in which a clear intention to create legal relations is required. Otherwise the agreement will not be a contract but merely a ‘political agreement’;
- Where very large projects are concerned, it might be necessary to avoid the whole risk of not meeting common law contract criteria and use specific legislation to ensure an agreement cannot be challenged (provided the power to en-force was existed in the first place). Examples of this can be found in infrastructure agreements for large privately managed expressways and for mining agreements.

Unauthorised contract

The key danger is an Agency being held to an agreement that is not in their best interests from a contract formed between the contractor and the Agency by a person who is unauthorised to commit the Agency.

A valid, but unwanted contract could arise if the contractor can show that they:

- Reasonably thought that an employee from the Agency had the authority to make a commitment;
• Relied on the Agency’s decision; and
• Wants to uphold that decision.

In short, an Agency could give ‘ostensible’ (or apparent) authority to enter into a contract. In particular, Agencies need to be careful when there is either a change of requirements or there is informal communication during the negotiation phase. There is a danger that negotiations could inadvertently ‘drift’ into a commitment. It is the responsibility of the Agency to advise officers of their individual authorities to contract.

**Possible controls**

Agencies need to manage various stages of the legal decision-making process:

• Ascertain the source of authority;
• What, if any, authority is given to a person or body by legislation? (This is particularly applicable to statutory corporations.) What authority is allowed and provided by executive power?
• Ascertain delegated authority;
• Ensure it is formally allowed by the source ascertained above to which person / body is it given;
• Establish internal written procedures.

These must define the scope of executive authority of staff members in relation to the award or execution of contracts.

• Limit or eliminate the use of surrogate (i.e., agent) of authority;
• Surrogate authority might occur usually at high management levels. Someone is acting on behalf of and in the name of the authorised officer. Where possible, use delegated authority instead, because surrogate authority often leads to invalid or unwanted decision-making.
• Establish instruments of delegation;
• Authorities could be clearly written and refer to the precise section of legislation or document by executive power that permits the delegation. In general, a delegate cannot delegate to another person.
• Manage implementation of the decision;
• Ensure that the authorised decision-maker provides the decisions on what is to be done, not just provide guidelines. The danger is leaving it to others to decide which applications comply with the decision, when they do not have the authority to make those decisions.
• Avoiding estoppel problems.

Possible ways of reducing the likelihood of estoppel problems are:

Before negotiations a letter is sent to the proposed contractor explaining that ‘negotiations are subject to written contract’.

Place in the both draft and final contracts the names, positions, and extent of authority given to persons dealing with the contractor. This makes it far more difficult for the contractor to show that they reasonably thought a contractual arrangement outside these conditions was established.

Document all discussions and provide a copy to the contractor and Agency senior management.
A9.3 Tendering risks

Public sector tendering typically relates to the process of determining who is to be awarded Government contracts. The tender process has two policy objectives:

- To ensure that the Agencies obtain best value; and,
- To ensure that the process is promoted in such a way that all interested parties have reasonable access to it.

From a legislative viewpoint only the first point, ‘best value’ is regulated in Australia, while the second point of ‘access’ is not, as yet, legally enforceable, at least in terms of access by overseas applicants.4

In large or complex tendering processes the terms provided by the Agency could make the ‘request for tender’ a two contract process i.e., one to govern the pre-qualification (or award) period and the other to govern the tender process and invitation for bids for the main contract.

The key risks are:

- Wrongful exclusion of applicant from tender process;
- Challenge to contract award;
- Failure to complete contract before practical commencement;
- Breach of contractor confidentiality;
- Misleading or deceptive conduct (see 7. Trade Practices/ Fair Trading Acts);
- Fraud (See 8. Fraud Risks)

Wrongful exclusion of applicant from tender process

This is likely to occur when an Agency asks prospective contractors to undertake a pre-qualification process, seek registration (or expressions) of interest or conducts a selective tender. There are a number of possible reasons why an Agency might seek to do undertake a pre-qualification process:

- To obtain a preliminary look at what and who might be able to offer their services;
- To determine whether to choose tendering versus private arrangement as most appropriate method; or
- To create a short-list of potential tender applicants that appear to meet the required key criteria. This can reduce the cost of having to consider in detail many applicants’ who have no chance of being awarded the contract.

A risk is that the expression of interest fails to indicate the level of detail or technical specificity required by the Agency, and as a result, an interested party is unfairly eliminated from the short list. This could result in formal complaints and delays or revision of the tender process.

4 This could change if Australia were to sign the World Trade Organisation’s Agreement on Government Procurement (1996).
Challenge to awarding of contract

Some likely scenarios include the following:

- The Agency awards the contract to an applicant when one or more other applicants’ rank higher on the objective criteria described in the pre-award contract. This could result from a failure to properly evaluate the tender in accordance with the prescribed priorities and methodology in the Request for Tender.

- An unfair choice could result from over-riding the criteria without notifying and issuing a formal variation to all applicants and allowing them to re-submit.

- Post tender negotiations occur with some applicants when the request for tender makes no allowance for negotiation; and,

- Where a major contract variation occurs immediately after the contract is awarded which more or less changes the essence of the original contract.

Depending on the circumstances, this risk could result in an Agency being sued for one or more of the following: breach of contract, misleading conduct, negligence and estoppel. It could also result in an injunction to stop the tender or contract from proceeding in accordance with the TPA and FTA. In addition, the consequences can include an official enquiry and loss of reputation and image.

Failure to finalise contract before practical commencement

A contract could be formed either at the date of selection of the approved applicant, or at a later date upon formal execution of documentation (i.e., a ‘subject to contract’). A danger is failure to finalise the contract before practical commencement. The distinction is important since an Agency might not have recourse to a contract remedy if an adverse incident occurred before the contract being completed.

This risk is often driven by both parties wanting to ‘get on with the job’ and because of time constraints. There is also the danger that once a tender has been awarded, knowing that the Agency has a tight deadline, the contractor could deliberately and successfully bargain for more favourable terms. The result for an Agency could be higher costs and a greater assumption of risks than initially planned.

Example:

An Agency selects the contractor to undertake building maintenance and considers the contract to have been formed. However, the ‘standard terms’ used in the tender stipulated that the contractor was obliged to sign a formal agreement, which included an indemnity clause. Despite continuing discussions over contract terms, the contractor nevertheless commences work four months before the formal signing. In the interim, the contractor caused extensive damage to a property adjoining that to the Agency. At the time of the accident, the terms regarding indemnity obligations had not been completed and the contractor denies any obligation under the indemnity clause.

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5 A leading case on this topic is Hughes Aircraft Systems International v Airservices Australia. (1997) 146 ALR 1.
An extreme version of this risk is failure to finalise the contract before practical completion. From a legal perspective, contracts do not require formal documentation unless the terms of the tender make the position very clear that they must.

For example, an Agency might find it is exposed to high and unnecessary risk if a contractor was allowed to prove they had the requisite approval or licence only after the contract was formed. Tender documentation should be clear when a contract is to be formed and Agencies must ensure practical commencement does not occur before satisfaction of all key terms.6

Possible controls

- In order to reduce the chance of commencement of work before finalising the contract it is necessary to define what is required to finalise a contract.
- One way of doing so, is to ensure contracts separate written ‘conditions precedent’ i.e., conditions necessary in order to establish a contract, from ‘conditions subsequent’, i.e., conditions that can be met at some defined stage after the contract has been formed.
- Choosing all the necessary conditions and whether they are precedent or subsequent can require considerable expertise and analysis of the risks involved.

Breach of contractor confidentiality

Confidentiality can be a critical issue for applicants who need to protect their competitive advantage in relation to skills, processes, technology and methodologies.

The release of this information by an Agency, whether deliberately or inadvertently, could lead to a breach of contract or common law, leading to the aggrieved applicant being awarded payment from the Agency for damages linked to estimated loss of expected future income.

Risks associated with contract variations

Variations to a contract could be sought by:
- The Agency on the contractor; or,
- A contractor on the Agency.

Variations to the original contract for services, product or major works programs fall into three broad categories:
- Additional work;
- Reduced work; and
- Reworks.

The key objectives in managing variations is to:
- Minimise the occurrence of costly variations.
- Ensure that when any variations are required, the cost is minimised.

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6 Precedent cases include: City of Box Hill v EW Tauschke Pty Ltd (1974)VR 39; and Masters v Cameron (1954) 91 CLR 353.
• Promote variations that provide improved outcomes.

If the variations are large or continuous, an Agency could be open to some of the following risks:

Cost overrun from additional works

This is a common and often high-level risk. If inadequately managed, variations can result in significant blow-out of budgeted costs, major delays in completion, interference with normal operations and disputation. Some Agencies have had their allocated budgets exceeded by millions (or tens of millions) of dollars because of the impact of variations.

Cost overruns could jeopardise the value of undertaking the contract. The risk is often due to the wrong contractor being chosen or the contractor perceiving that the Agency miscalculated the contract’s requirements. Often Agencies that over-emphasis the need for choosing the lowest price tenderer are more likely to have problems with cost overruns and consequently fail to achieve the best outcome. In retrospect, either an alternative contractor or undertaking the job in-house could have provided the required construction, product or service at a better final price.

Cost overruns from reworks (due to principal’s variation)

Major reworks could involve additional costs of redesign, excavation, demolition, haulage, waste disposal, and the lost expense and time of work already undertaken. Of particular importance is inadequate design, since the cost of rectification or a complete start-over can be considerable. A common cause of major cost overruns and rework is a poorly scoped contract (see 5.1 Inadequate scope).

Failure to benefit from reduced scope/ innovation

Contract terms need to include clauses to allow the Agency to fully benefit from any scope reductions that might be required and to promote outcomes that exceed minimum performance requirements.

In the later case, contract terms need to encourage mutually beneficial changes and innovations instigated by either party. An example would be to include in the contract allowance for the contractor to share in cost savings to the Agency arising from the contractors suggested change to previously agreed design, work methods or materials.

Latent conditions

Latent conditions refer to adverse circumstances during practical works that could not be reasonably controlled or foreseeable by the Agency or contractor. Examples are the finding of an underground well or waste dump on a work site, or any hidden service lines that are not on survey plans. It could also be the uncovering of a heritage site full of artefacts.

The impact of latent conditions might include changes to the contractors’ work method, the approved contract design, location of works, and/or increased costs for one or both parties. The key issue is how the contract accounts for this risk and who pays?
Variation not approved by Agency (but upheld in law)

The risk of estoppel is particularly important for managing variations. Some risks can be linked to inadequate administrative processes.

Example 1:

A contractor sends a letter to the Agency seeking a change in the method used for calculating payment. The Agency does not reply to the application (E.g., laxness). The contractor sends invoices based on the proposed method. The Agency’s accounts payable department pays the invoices. The Agency is held to have agreed to a variation of contract.

In this situation it could be argued that the offer (the letter seeking a new payment method) was accepted since it was reasonable to assume that the payment was the form of acceptance. The contractor can reasonably assume that the Agency had internal processes that ensured they had processes that validate internal approvals by authorised persons.

Example 2:

Unexpected additional works are required to continue a job for example. A builder hits very hard rock that was not included in the scope of the contract. An officer representing the Agency thinks ‘well, there is no alternative, I’ll get a retrospective approval’ and in order to keep the project moving, he tells the contractor to proceed. The contractor engages specialist extraction services at very high cost. The extra costs prove to be so significant that it would have been more appropriate to terminate the project and do the same at another location.

The apparent approval was upheld despite a contract saying that the contractor must provide a written notice for variations. The principal of estoppel can over ride what is in a written contract. In other words, common law allows parties to agree to change contracts, even if that agreement was based on apparent authority.

Conclusion

Variations in large or complex contract works or procurement are almost inevitable, and as such, Agencies need to be prepared for their occurrence. Even a ‘fixed price’ contract will vary in price if the specifications are changed. Without specific contract terms dealing with variations, contractors are in a particularly strong bargaining position in negotiating the price of variations if the owner seeks changes.

Usually it is not practicable or feasible to use other contractors to meet the additional work. A contractor who wanted to undertake the variation at normal profit margin might need to charge significant extra costs due to obtaining labour at short notice or additional transport and procurement costs due to special orders on source suppliers.

Possible controls

- Costly variations can be minimised by greater expertise and effort during the draft contract stage. In particular, ensure specifications properly represent the desired outcome and all regulatory requirements.
- Contingency amounts are required in the contract budget (as opposed to the contract price) to make allowance for reasonable variation costs.
- All proposed variations, whether by the Agency or contractor, need to be instructed in writing and approved by Agency senior management. Allow exceptions for urgent circumstances such as mitigation of critical safety or environmental threats.
- The costs/savings from the variation and the impact on the scheduled completion date must be agreed by both parties. If the parties are unable to agree, an independent valuer could make the determination. The contract will need to include this mechanism.
- The method of determining costs associated with delays or disruptions caused by the variation need to be including in contract terms.
- The contract needs to allow for the Agency to suspend the works (for any reason), and for resumption to occur at the Agency’s notice. When the suspension is caused by the Agency, the contract should include a pre-agreed maximum daily amount for each day of suspension.
- Include incentives to the contractor in the contract for successful innovation and favourable variations.

A9.4 Other major Agency-caused risks

Inadequate scope

The scope is a critical part of the contract. It explains what the Agency wants from a service, product, item of equipment or a construction. The main part of the scope is the specification, which is usually an extensive and detailed description of what is required in order to meet the essential deliverable(s) at contract completion.

More complex contracts might have the scope segmented into completed ‘milestones’ and linked to scheduled time periods.

The scope can be inadequate if it:

- Is too narrow and ill defined;
- Includes inaccurate information in important areas;
- Has an impractical requirement, for example, has unrealistic timeframe for performance;
- Is at odds with laws or regulations, for example, Building codes and Council regulations;
- Includes a specification that is biased, for example, brand names, and ‘only made in..’ clauses and;
• Inadequate design, selection (or use) of technology, or inefficient/ineffective required work methods.

• Does not truly meet the Agency’s needs.

• The last point- having a specification that does not truly meet all critical needs, is probably the most common error. The most likely cause is that those needs have not been adequately identified because of a lack of time, effort or expertise involved in analysis and evaluation required in the decision-making process.

• Common outcomes of inadequate scope could be:
  • Acceptance of long-term inefficient, ineffective or hazardous services equipment or fixed structures.
  • A high likelihood of expensive variations and unbudgeted cost over- runs in order to correct the initial inadequate scope.

See also (5.3) Major cost overrun and section 4. ‘Managing Variations’

**Example: Where needs have not been fully identified**

An Agency seeks to replace an extensive area of floor-space with new carpet. The quoted cost of doing so through NSW Supply is 40% more than that which the Agency can get from another source for ‘similar’ carpet with the same expected life, ease of cleaning and stain resistance. The Agency buys the cheaper version, but fails to realise that it lacks the fire-resistant rating recommended for public amenities and offices.

**Possible controls**

• Scope to link objectives and performance needs.
  Detail of the required scope should link the following two factors:

  Objectives; i.e., ‘How does this contract support business unit and organisational objectives’; and,

  Determine what performance is needed in this particular contract to be consistent with those objectives;
  the outcome is performance indicators from which the contract will be evaluated.

• The required ‘performance’ could be ascertained from a due diligence process that includes a checklist of relevant factors established by a committee of experts. The checklist might for example include the following aspects:

  Functionality: E.g., performance criteria according to industry standards;
  ‘Fitness for purpose’ in environment in which it will be used: i.e., how it ‘fits-in’ with existing system and appropriateness under all working circumstances;
  Cost: direct, indirect and ongoing;
  Health and safety;
  Strength and Durability;
Adaptability: i.e., ability to adapt to expected and potential changes;
Replacement parts and service;
Warranty;
Environmental compliance;
Legal compliance;
Aesthetic impact

- Risk Assessment.

Inadequate scope is mitigated by the conduct of a risk assessment before the issuing of a contract.

**Inadequate selection criteria**

This is a major risk. The wrong contractor could be chosen as a result of omitting essential criteria, making the wrong choice of criteria or applying the wrong weighting or scoring methodology to the criteria.

It is one thing to ascertain the right scope of works i.e., to determine ‘what specification is needed’. It is another matter to define, and then (in some cases) weight the criteria that are supposed to determine the ability of contractors to successfully perform the contract.

The selection criteria might include both a) specific requirements from the contractor and b) general characteristics that the Agency considers important for a contractor to have in order to meet contract terms and conditions.

These characteristics might include:

- Technical merit of goods or services provided;
- Experience and skills;
- History of compliance with contract terms and conditions;
- Management systems in delivering quality, safety, timeliness and efficiency;
- Financial viability;
- Life-cycle cost implications; and,
- Specific constraints with each applicant.

**Possible controls**

- Criteria to be Set By A Process Involving an Evaluation Committee of ‘Experts’.
- The final decision-maker often does not have all the necessary skills and experience to determine all the appropriate acceptance criteria. Consequently, the decision-making process might include expert opinion and recommendations for criteria. An evaluation committee should be established to both set the criteria and evaluate the applications against the criteria. The committee might for example, have a mix of financial, technical, legal, and operational experts and the proposed Agency contract manager.
- Choose an Appropriate Evaluation Methodology, and Apply It Consistently.
The committee will need to determine an evaluation methodology according to the size and technical complexity of the contract requirements. Simple purchases of standard items might have ‘cost’ as almost the only factor. At the other extreme cost could be given a very low priority if other factors are considered essential or important.

**Major cost overrun**

A major blow-out of budgeted costs for a contract or project could have a detrimental effect on an Agency’s entire finance budget and have flow-through effects on its ability to provide services and manage other risks.

It is not always possible, or desirable, to have a fixed price contract particularly when the work to be undertaken needs to be on a ‘as required basis’. Even ‘fixed price’ contracts have capacity for additional costs above prime cost (PC items) sub-limits contained within the contracted price.

Possible causes of a cost overrun might include:

- Inadequate original scope;
- A significant change in scope or base line plan might occur because the principal realises that it fails to meet all the required needs;
- Inadequate design, selection (or use) of technology, or inefficient work methods:

These are major issues that require evaluation during development of the specification. Problems with these matters could lead to variations, or having to accept inefficiencies that in turn raise the costs of delivering services.

- Inadequate budgeting:
- Expected costs are underestimated or there was an inadequate contingency included in the budget to reflect risks that impact upon costs, i.e., contract risks were not fully identified or evaluated.
- Choosing inappropriate contract criteria for work and payment.

An example would be an unlimited ‘work specified contract’ in which the costs paid to the contractor are fixed by a schedule of rates for each activity but the level of activity is determined by factors outside the control of the Agency. E.g. the weather in a road maintenance contract.

**Possible controls**

- Work specified contracts should be subject to Agency budgetary requirements.
- The more the contract is subject to ‘cost sensitivities’, the greater the allowed contingency cost within the total budget.
- Obtain expert opinion on design, technology and work methods (for example. Expert consultant) with adequate Professional Indemnity Insurance.
- Allow the design, technology and work methods to be agreed by the contractor as being adequate and documents that detail them to form part of their agreed proposal.
- See ‘Inadequate scope’ (5.1)
Inadvertent breach by Agency

If a contract is not carefully drafted or an Agency previously failed to notify the contractor of serious violations of contract terms, then the Agency could inadvertently breach the contract them-selves with precipitous action.

Either the contract conditions that the Agency acted upon were inadequate, or the Agency continually overlooked a breach, which could be considered in law, as a waiver of that condition. The result is that inadequate contract terms or not responding to breaches could place an Agency as the inadvertent ‘offender’.

Example:

Contract terms require that payments are made monthly to the contractor. The Agency refuses to pay because of an apparent breach i.e., inadequate work performance. The Agency responds by not paying the contractor. The contractor responds by not performing work and alleges breach of contract by the Agency because of non-payment of money that is due. Following a process of arbitration it becomes clear that the contract is ambiguous and unclear on the performance criteria but very clear on when payment is due from the Agency. The result could be the Agency is left with a court order to pay for the contractor’s overhead costs, wages, lost profit and is still left with a ‘under-performing’ contractor.

Possible controls

- In general, it advisable for Agencies to place in contract terms the requirement that payment to contractors is on the basis of specific performance rather than on a time period basis.
- Obtain legal advice. Advise contractors in writing when they breach conditions or warranties and advise of your intention to either act or reserve all your contract rights.

A9.5 Unauthorised contracts

The key danger is an Agency being held to an agreement that is not in their best interests from a contract formed between the contractor and the Agency by a person who is unauthorised to commit the Agency.

A valid, but unwanted contract could arise if the contractor can show that they:

- Reasonably thought that an employee from the Agency had the authority to make a commitment;
- Relied on the Agency’s decision; and
- Wants to uphold that decision.

In short, an Agency could give ‘ostensible’ (or apparent) authority to enter into a contract. In particular, Agencies need to be careful when there is either a change of requirements or there is informal communication during the negotiation phase. There is a danger that negotiations could inadvertently ‘drift’ into a commitment. It is the responsibility of the Agency to advise officers of their individual authorities to contract.
Possible controls

Agencies need to manage various stages of the legal decision-making process:

- Ascertain the source of authority;
- What, if any, authority is given to a person or body by legislation? (This is particularly applicable to statutory corporations.) What authority is allowed and provided by executive power?
- Ascertain delegated authority;
- Ensure it is formally allowed by the source ascertained above and to which person / body is it given;
- Establish internal written procedures.

These must define the scope of executive authority of staff members in relation to the award or execution of contracts.

- Limit or eliminate the use of surrogate (i.e., agent) of authority;
- Surrogate authority might occur usually at high management levels. Someone is acting on behalf of and in the name of the authorised officer. Where possible, use delegated authority instead, because surrogate authority often leads to invalid or unwanted decision-making.
- Establish instruments of delegation;
- Authorities could be clearly written and refer to the precise section of legislation or document by executive power that permits the delegation. In general, a delegate cannot delegate to another person.
- Manage implementation of the decision;
- Ensure that the authorised decision-maker provides the decisions on what is to be done, not just provide guidelines. The danger is leaving it to others to decide which applications comply with the decision, when they do not have the authority to make those decisions.
- Avoiding estoppel problems.

Possible ways of reducing the likelihood of estoppel problems are:

Before negotiations a letter is sent to the proposed contractor explaining that ‘negotiations are subject to written contract’.

Place in the both draft and final contracts the names, positions, and extent of authority given to persons dealing with the contractor. This makes it far more difficult for the contractor to show that they reasonably thought a contractual arrangement outside these conditions was established.

Document all discussions and provide a copy to the contractor and Agency senior management.

Adverse impact from contract termination

Contracts usually allow for termination. Termination might occur as a result of contractor insolvency, default by the contractor or sometimes in accordance with a clause allowing ‘termination for convenience’ by the principal.
In normal practice, termination would be considered a last resort when problems arise. If an Agency wrongfully terminated a contract, that act is itself a lawful breach that could lead to the contractor having the right to terminate and seek damages, i.e., a reverse termination can occur.

A key driver behind this risk is a lack of clear and adequate clauses in a contract concerning termination. Without the proper clauses, common law requires that termination can only occur on a serious breach. ‘Serious’ would not include for example, that the product or service is no longer required. Such an act would result in contract repudiation.

Careful drafting of a contract will make it clear what constitutes a breach that can justify termination.

Possible controls

Some possible options (which would require legal advice) might be to consider including:

- ‘Show cause’ and ‘time to rectify’ clauses:

  These might reduce the chance of over zealous and ill-informed actions by an Agency leading to termination. However, merely having such clauses in a contract will not protect an Agency. Agencies must adhere to them. There is nothing to stop an Agency wrongfully declaring a termination by bypassing ‘show cause’ and ‘time to rectify’ clauses.8

- Include termination for convenience (if possible):

  This enables an Agency to terminate the contract at anytime and for any reason provided there is a reasonable period of notice and compensation for loss of profit on the remaining part of the contract term.

Loss or failure to own contractors’ intellectual property

In some contracts obtaining intellectual property is the key value of the contract. Contractors can either bring intellectual property to the Agency or develop it during the contracted work. Examples could be software, detailed design and publications.

A danger is when intellectual property remains the ownership of the contractor but the Agency needs ownership in order to control its use, make alterations or update it with changing workplace conditions. There is also the danger that the Agency infringes the copyright or patent resulting in remedies such as an injunction and damages for loss of profits.

Not having ownership might result in high ongoing costs, which were probably never budgeted for, since the contractor’s additional time or authority (at a cost) is needed when new applications are required. Alternatively, not having ownership could mean that the value of the intellectual property is lost or becomes redundant if the owner refuses, or is unable to, provide a maintenance or upgrade service.

Possible controls

- Obtain legal advice before entering into a contract.

Intellectual property is a complex legal area, so legal advice is important.

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8 Amann Aviation Pty Ltd v Commonwealth (1991) 174 CLR 64. The wrongful termination cost the Government $6 million.
The result might be the inclusion in the documentation clauses that ensure knowledge developed by the contractor during the contract period is owned by the Agency. Consideration might also be given to ownership or having a license to use intellectual property that was brought into the job.

**Failure to notify contractor/supplier of defects within defects/warranty period**

The key dangers are not notifying the contractor of defects existing before either:

- The signed contract completion date; and
- Before expiry of any contract warranty period or statutory claim period (such as in the Building Code or Sale of Goods Act).

The impact of these errors could be to lose a contract or statutory right to claim upon the contractor to correct the defect, obtain costs to rectify, or receive damages for under-performance.

Identification of defects and performance testing can be undertaken at completion of various steps in a contract where they can be identified and measured. Not doing so, can cause further delays and compound current problems. However, the most important test is at practical completion when full and complete testing is required before contract completion is signed.

**Possible controls**

For large or critical processes:

- The contract needs to include a test requirement by the contractor on all parts of the work specified in the contract (according to an assessment completed before contract formation). The process might also require the Agency to undertake their own tests to verify the results.
- As part of the asset management program, a certain job role (for example, Property Manager) is given the responsibility to record a final review date before the expiry date for defect/warranty periods. This review is recorded in writing and made available for audit purposes.
A9.6 Major contractor-caused risks

Risks that might lead to adverse outcomes caused largely by the contractor will depend upon the nature of the contracting activity. The word ‘largely’ is important since there is always the possibility that the actions or omissions of an Agency could be a causal factor in the adverse outcome. An example is contributory negligence.

Some risks worth considering are listed below and some of these could be sub-divided into many potential causes/scenario types:

- Failure to meet contract specifications.
- Major delay in contract completion (E.g., industrial disputation, supply problems in human resources or materials and equipment).
- Severe damage by contractor/subcontractor to Agency/third party’s property.
- Major interruption to Agency/third party operations.
- Death, major injury or adverse health impact.
- Severe adverse impact on environment.
- Major fire/explosion/implosion.
- Theft of Agency/client/third party property.
- Assault by contractor on Agency staff/client/intruder and so on.
- Unauthorised release by contractor of Agency/client information
- Breach of Agency security (E.g., resulting in release of inmates, detainees, patients, and so on)
- Contractor insolvency

Details in relation to the above-mentioned risks (and any others that need to be added) depend upon the nature of the contract or project being undertaken. The role of Agencies is not to run the contractor’s business. However Agencies must ensure before the awarding of the contract, (or have as a condition precedent to commencement to practical work), that they have systems in place to manage their risks.

Possible Control

- Need For A Joint Assessment of Risks:

Ideally, the best way of confirming that contractors have those systems, or need to improve them, is for Agencies to be jointly involved with the contractor in undertaking a risk assessment of specific risks for the work or project. It should be a co-operative and not a ‘hands off’ arrangement undertaken immediately following formation of the contract. The need for a joint risk assessment could form part of the contract.

The exceptions would be for risks that require confidential inquiries or raise ‘sensitive issues’ such as contractor insolvency. Further comments on some of the above-mentioned risks are as follows:
Major delay in contract completion

Causes could be diverse. Examples are industrial disputation, supply problems in human resources or materials and equipment.

In relation to industrial relations, it is recommended that Agencies obtain and incorporate guidelines provided by NSW DPWS titled *Industrial Relations Management: Guidelines* (1999).

Death, major injury or adverse health impact

This applies to any person(s) including the contractor, Agency staff, Agency clients or third parties. ‘Chronic’ OHS and R risks – typically risks with lower level consequences but with high frequency might also need to be considered. Health related risks often have strong a relationship with other risk areas particularly environmental, property damage and business interruption risks since the impacts could affect one or more of these areas.

Statistically, it is the many small contractors that are involved in the greatest number of serious accidents.

There are four levels that form a system for managing OHS&R risks. The system can be described as follows:

1. Accredited Corporate OHS&R Management System;
2. Project OHS&R Management Plan;
3. Site-Specific Safety Management Plans;

In diagrammatic form this can be shown as follows:

![Diagram of OHS&R Management System]

Possible controls

- Determine the level of OHS&R system required:

As a condition precedent to the contract, contractors need to show that they have an appropriate level of safety management systems and processes according to the size and sensitivity of the work to OHS and R issues. A joint risk assessment following the contract being awarded should recommend the appropriate level. The decision process to determine the appropriate detail and structure of health and safety controls for contracted works should include a qualified OHS&R person. If the recommendation of that person differs from the decision, their opinion should be documented as part of that process.
The lower the level chosen, the more management control is required by the Agency:

For example, if the Agency accepts the process described by Safe Work Method Statements, then the Agency will need to more actively involved in formation, acceptance and monitoring of those processes.

Agree on management of high-risk activities:

Certain high-risk activities identified might require agreement on particular OHS standards, accreditation requirements, or benchmarks applicable to them. This is particularly important if industry standards are not required in law, or the requirements under law are minimal rather than adequate, or there are more than one recommended option to choose from.

Contractors should be asked, “on the basis of what safety standards do you propose to undertake your work?”. The evaluation of the appropriateness of that standard needs to consider additions or variations to fit the site circumstances. The standard should then form part of contract conditions.

Audit and remedies:

Ensure contract terms allow the Agency to audit the OHS&R system, management plans or statements and the practical implementation of them. Contract terms need to allow the Agency to apply appropriate sanctions and remedies, including an order to stop work, to seek rectification or even to terminate the contract without penalty to the Agency.

Severe adverse impact on the environment

Environmental harm could occur from contractor works affecting air, water and land quality, or wastage of energy. The major issues are usually discharge of excess water or pollutants into drains or watercourses; toxic air emissions; and damage to soil, wildlife or plants.

An important aspect for Agencies to recognise is that they could be held liable for fines and remediation costs when contractors cause damage, exceed approved levels of waste discharge (as allowed by the EPA) or if a waste dump has no license to take waste.

Possible controls

Refer to the same 3 controls in the above-mentioned OHS&R risk, except apply the need for an Environmental System and Management Plans. The following guides could be obtained and applied:

- Environmental Management System Guidelines – from NSW DPWS
- Environmental Management System: ISO 14001 and 14004 (for Audit)

Contractor insolvency

The implications of having an insolvent contractor could range from minor to catastrophic. The impact could vary according to the stage of works that remain incomplete, the availability and bargaining position with suitable alternate contractors and suppliers, the amount to which the Agency assumes the contractors debts and the importance of meeting the scheduled completion date.

Businesses cannot legally trade while insolvent. Depending upon the nature of the insolvency administration, (such as liquidation, receivership, or scheme of arrangement) an insolvent contractor might have to stop work. The appointment of an official administrator means that the contractor is not obliged to continue to meet existing contracts and debts owed by the contractor at the time of the appointment. Nevertheless, an administrator might be able to negotiate continuation of the work under new terms.
A contractor might become insolvent for many reasons. Some typical reasons include:

- Failure to adequately perform key contract conditions and hence is not paid;
- Failure to adequately perform on past or concurrent contracts with other clients;
- Major unpaid debts by their other clients;
- Failure of a key subcontractor, either financially or in contract performance;
- Major stoppage caused by for example: strikes, failure of key supplier, inability to obtain critical approval from some authority.
- Inability to meet the level of indemnification required in the contract when an event, caused by the contractor, results in a catastrophic loss to the Agency or a third party.

Typically, underlying much insolvency are high-levels of debt to share capital compared to other industry competitors, a high reliance on one or two large contract jobs, inadequate cash-flow management, bad debts and inadequate technical operating performance.

**Possible controls**

- Continuous assessment of credit-worthiness:

  The pre-award evaluation must include both the impact of contractor insolvency on the Agency at all stages of the contact and the ability of a contractor to remain solvent when cash flow is unexpectedly weakened. This must be done by experienced persons in financial reporting analysis and with adequate knowledge of the contractor’s industry. If major weaknesses are identified Agencies could exclude interested contractors at the pre-qualification stage of tendering.

- Credit enhancement:

  If the applicants financial position is marginal they could be required to provide adequate third party support in the form of bank or parent company guarantee, or unconditional performance bonds from insurers or other confirming houses.

  For example, in the case of construction contracts, typically they require the contractor to provide performance and retention guarantees of between of between 5% to 15% of the contract value. However experience suggests that the additional cost to the principal resulting from contractor insolvency can be in the order of 40% or more of the contract sum. One option is to include in the contract a requirement that the contractor obtains a **completion bond** from a third party in favour of the principal for up to 100% of the contract sum.

- Adequacy of contractor indemnity:

  The value of any contractual indemnity provided by the contractor is limited to the lesser of any contract indemnity limit and the contractor’s financial ability to meet the loss.

Consequently, if an indemnity is to be worthwhile both these aspects must be compared to the maximum reasonable loss for any identified loss event.

- Standard contract clauses to mitigate losses:

  Certain clauses in the contract will assist in reducing some potential losses arising from contractor insolvency. They are as follows:
Right of set-off: This allows any amounts payable by the contractor to the Agency, to be deducted from any payments due to the contractor. Without this, an insolvency administrator could call on any amounts due to the contractor.

Avoid having to pay any unpaid wages of the contractor’s employees by requiring the contractor to submit with all invoices, a signed statement “... that no wages are due and owing by the contractor in respect of the work at the time of payment.”

- Contractor insurances (also, see section on insurance):

The likelihood of insolvency from insurable losses can be reduced if the contractor has appropriate insurances. This includes legally required insurance, other appropriate types of insurance and the required limit of cover according to operational exposures.

In addition to the common insurances including Workers’ Compensation, Public Liability, and Third Party Motor Vehicle insurance, other typical insurance requirements could include, but are not limited to Property, Machinery, Professional Indemnity, Industrial Special Risks and cover for financial loss by having Advanced Business Interruption insurance.

Breach of Trade Practices or Fair Trading legislation

Some Agencies are at risk of breaching legislation from the way that they conduct the contracting process, particularly in tendering and the sale of goods or services. There are four Acts of importance:

1. Trade Practices Act 1974 (Commonwealth)
2. Fair Trading Act 1987 (NSW)

One essential aspect to ascertain is for Agencies to obtain legal advice on which Acts or provisions apply to them. The answer can be complex, but some guide can be given by the following:

In NSW the TPA applies to Agencies to the extent that:

- They are defined as corporations and,
- Only under the competition provisions of the Act (namely, Parts IIIA, IV, and XIB).

Certain state Government owned statutory corporations and Government business enterprises are bound by the Act to the extent that they are not given specific immunity and carry on a business. A ‘business’ includes non-profit organisations and current case law indicates that they need to be involved in repetitive transactions. Unfortunately, at this time, a precise definition of what this means is not clear and consequently Agencies need to obtain their own legal advice.

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9 In accordance with Section 154 (1) of the Industrial Relations Act (NSW).
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In NSW the Fair Trading Act 1987 (NSW) covers all legal entities, not just corporations. This means that if liability cannot extend to an Agency under the TPA, it might be covered under the FTA. It is important to recognise that in addition to the FTA, statutory recognition is given to ‘Codes of Practice’ that together creates a form of co-regulation.

Following the ‘Hilmer Report’ in 199311 the NSW Government, like other States began to adopt a Competition Code in their Competition Policy Reform Acts.

Trade practice risks is increasing due to the growth in many Agencies operating in a commercial context.

The key risks are:

- Misleading or deceptive conduct in trade or commerce;
- Unconscionable conduct;
- Anti-competitive conduct;
- Product liability.

**Misleading or deceptive conduct**

Section 52 of the TPA and corresponding sections within the FTA (s42) applies to a wide range of activities. The risk involve situations that Agencies might cause other parties to believe something that is untrue (i.e., a false representation), to mislead them as to a matter of fact, or to lead them into error because of some statement or action that a recipient would reasonably expect to rely upon. In order to seek damages, the

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10 In accordance with Section 154 (1) of the Industrial Relations Act (NSW).
11 Report by the Independent Committee of Inquiry into National Competition Policy (1993), AGPS
Some unknown lessens obtained unconscionable under contracts, be deemed defence. The commercial arrangement: the damage.

Example: The key risk area is in negotiating a contract

An Agency issues a tender for the construction of a very large capital project. The Agency departs from the rules it sets in that tender. An applicant that loses in the tender process claims that they were unfairly treated. That applicant successfully claims damages to cover the cost of preparing the tender (these costs could, for example, be in the hundreds of thousands of dollars) and succeeds in seeking a court injunction to stop the tender process.

Another example would be misrepresentations made by an Agency wanting to lease part of its building to a shopkeeper concerning suitability, such as access, by customers.

Unconscionable conduct

Under the TPA, s51AA and AC, and the Fair Trading Act NSW (1987) s43, applicable Agencies are not to engage in conduct that is considered unconscionable.

The relates to the sale of goods or services for domestic purposes where the contract arose as a result of exploiting persons with a special disadvantage such as persons who do not understand English, are commercially naive or suffer from a physical or mental disability.

The main outcome for the Agency is likely to be adverse publicity.

Anti-competitive conduct (sec 45 TPA, also Restraints of Trade Act)

Contracts, arrangements or understandings entered into by Agencies could be deemed to substantially lessen competition. It includes, for example, commercial leases and licences of land. The term ‘contracts’ includes agreements that are not contracts in the strict legal sense. Potential danger areas include the following:

- Agreements constituting ‘codes of ethics’ that limit competition;
- Standard forms of contract and uniform terms of trade that impede competition;
- Market sharing agreements in which an Agency might agree with another Agency or commercial organisation to allocate or divide customers, territories or sales for any goods or services.

The defence must be that the public benefit of the activity outweighs the public cost. Agencies need to obtain legal advice before engaging in potential anti-competitive conduct.

Product liability (Part 5A of TPA)

An Agency contracts to sell a product to a customer that is used according to instructions and causes that customer harm. In addition, the product is either manufactured by the Agency or by a manufacturer unknown to the Agency.

Some Agencies produce products for contract sale. In addition, considerable product can be sold (or provided freely) from manufacturers. In the second instance, an Agency could, for the purposes of the TPA, be ‘deemed’ to be the manufacturer and hence liable for harm caused by instructed use if the manufacturer couldn’t be identified.
Possible controls (for all above-mentioned risks)

- Obtain legal advice to identify which, if any Acts, you might be bound and determine if you already engage, or intend to engage, in contracting activities that could lead to any breach;
- ‘Trade practice’ issues should be a mandatory consideration in risk assessments;
- Ensure the purchasing system prevents the purchase of products from any supplier in which the manufacturer cannot be clearly identified. E.g., where a distributor replaces the manufacturers label with their label;
- Mandatory staff training both at induction and in periodic reviews/updates;
- Include ‘defences’ against breaching proper practice in operating procedures, supervisory activity and authority levels;
- Audit compliance.

Fraud

Nature of Fraud

Fraud is a generic term that covers many situations and legal definitions. In essence, though, fraud means the deliberate deceit by one or more persons on another person(s) with the intention of obtaining an illegal gain. The main fraud categories in law include the following:

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<tr>
<th>Fraud</th>
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<tr>
<td>Larceny</td>
<td>Theft of property</td>
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<tr>
<td>Embezzlement</td>
<td>The wrongful appropriation of property that has been entrusted to another</td>
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<tr>
<td>Fraudulent misappropriation</td>
<td>The unauthorised use of money or property for the benefit of self or other parties</td>
</tr>
<tr>
<td>False pretences</td>
<td>Misrepresenting the facts in order to obtain the property, money or information for wrongful gains</td>
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Fraud is a major risk during all stages in the contracting process. Fraud can involve breaches of both civil (E.g., Trade Practices Act.) and criminal law, or involve contractual offences such as in deliberate false execution of a contract.

Fraudulent activity can involve one or more persons from many different parties in the contract processes. The fraud could be committed in-house, or by the contractor or between applicants, or from a combination of these parties. Fraud is particularly difficult to identify and manage when there is collusion of persons from different parties in the contracting process. Fraudulent activity can be simple or highly sophisticated in its execution and is undertaken from persons of all walks of life.
The costs of fraud to an Agency include paying larger than ‘market’ prices for tenders, receiving lower than expected income from sales, loss of inventory and services, and adverse impact on an Agencies reputation and image.

In the worst cases, fraud is distinguished from many other risks in that it has the potential to be undetected for long periods of time, or is never identified, and there is little avenue for recovery of loss from the perpetrator or via insurances.

**Key contracting fraud risks**

There are many fraud mechanisms that could occur during the sale or purchasing cycles of contracting. Some frauds are common to most operational activities, E.g.,

- Fraudulent misappropriation of receipts or payments;
- Theft of cash;
- Contractor Pay / Invoicing fraud.

In addition, the following five risks have particular applicability to contracting:

- Bid or tender rigging;
- Bid or tender fixing;
- Kickbacks and inducements;
- Work done/goods supplied for private purposes;
- Dummy suppliers.

**Bid or tender rigging**

This involves the manipulation of the competitive bidding process. Applicants could conspire to agree to prices and terms for a particular contract.

For example, applicants could agree between themselves who is to provide the lowest offer but nevertheless ensuring that the offer is inflated above what a competitive market would have provided. All the bidders win because the ‘losers’ receive a fee from the winning applicant that is paid out of the inflated contract price. In the next tender another bidder from the same group is chosen to be the ‘winner’ and the process continues on the same way.

This has, for example, occurred in the building industry.

**Bid or tender fixing**

Bidders obtain inside information, usually in return for a kickback paid to an employee of the purchasing Agency. The effect of bid or tender fixing is that the Agency, as purchaser, obtains less favourable terms and pays a higher price than it would otherwise have done had a truly competitive tendering process operated.

An example would be to acquire knowledge of other bid prices and selection criteria so that the informed bidder does not offer a substantially lower price than might otherwise benefit an Agency. In certain cases the effect is much more damaging- the specifications for an entire project might be inappropriate. At a more organised level ‘information brokers’ act as intermediaries between employees and tendering companies.
KICKBACKS AND INDUCEMENTS

Essentially the same as bid or tender fixing except it takes place outside the formal tender process. An example would be a purchasing officer choosing suppliers that favour them rather than their organisation.

Work done/goods supplied for private purposes

This means that during the receipt phase of the purchasing cycle goods or services are acquired for personal purposes. This could involve the fraudster appropriating Agency assets or using Agency time for private purposes.

Dummy suppliers

Payments might be made to dummy suppliers for services never provided, or amounts are posted to accounts of suppliers that an Agency has in fact stopped using.

Comment

The root cause of fraud is not limited to inadequate systems and processes of internal controls. To do so would suggest that fraud is only perpetrated when systems are weak and temptation is strong. The work ‘culture’ is also important.

For example, persons who know they could get away with committing a fraud might not do so, not only because of ethical considerations, but because they have a strong respect for their employer and/or supervisors. The right culture is more likely to be obtained when employees have a clearly defined job role, appropriate work scheduling, support in developing competency, reasonable financial and non-financial reward for effort, and provision of a safe and effective work environment. In choosing contractors, Agencies need to look at their abilities and reputation in terms of controls and culture.

Possible controls

Possible Warning Signs For Fraud:

The following are just a few of some typical warning signs that a fraud might have occurred or could easily occur:

- Abnormal prices or terms i.e., specifications that can only be met by one supplier;
- Prices of bids close together;
- Vague terms in contracts and no detailed review of charges such as travel, advertising, consultancy fees, recruitment, maintenance and leasing;
- Changes to the specifications or price soon after the contract is awarded;
- A large number of invoices for a particular supplier just beneath approval threshold, thereby avoiding more formal tendering procedures;
- Well-known suppliers not asked to tender;
- Tenders accepted after closing date (so the final tenderer could have illegal access to all the prices);
- Unusual delivery times or methods;
- Ambiguous or abbreviated descriptions on invoices;
- Suppliers with post office box addresses or the same address as another company, employee, next of kin or former employer.
• Establish Policies and Procedures.
• Agencies could have comprehensive policies and procedures covering all fraud areas. This would
  include definitions of conflict of interest and allowable ‘gifts’ and a well defined internal feedback
  communication system (i.e., who do you talk too if you suspect!). The process must be reviewed,
  tested (i.e., audited) and updated.
• Included in the policy for supply contracts could be a ‘right to audit’ clause. This would be a
  standard contract clause only be waived by a designated approval authority. The clause would need
  to cover many procedural aspects including who is authorised to perform the audit, advance
  notice, duration, communication of findings, what can be audited, what information will
  be required and who is responsible for paying for the audit (usually it is the auditing organisation).
• Provide Sufficient Expert Resources To Manage Anti-Fraud Activity.
• It is essential that sufficient resources and time is given to identifying system weaknesses. This
  could involve evaluating anything from recruitment of appropriate staff and checking the history of
  contractors to confirming the integrity of quotes and offers.
• Often the role of ‘fraud management’ is left to the internal auditor with some reliance given to an
  annual audit by an external auditor. However, fraud management is not a specific role of auditors.
  In general, external auditors are only responsible for informing management, or external regulatory
  bodies, of actual or suspected fraud if it is identified during normal audit procedures. Unless
  auditors or other professionals are specifically requested to monitor and manage fraud prevention
  and detection systems it is unlikely that it will be properly managed.

Insurance risks

Objective
The key aim is to ensure that the contractor’s insurers, rather than the Agency, finance insurable losses
caused by the contractor. Having adequate contractor insurance is a common and important way for
Agencies to reduce exposure to insurable losses arising from some adverse events.
Evaluating the required contractor insurances and its ongoing effectiveness is a specialised activity to be
undertaken by experienced Agency staff or by a consulting expert such as a specialist insurance broker.
Obtaining expert advice is particularly important for Agencies because most Agencies have little or no
commercial insurance experience. Consequently Agency expertise in this area could be lacking.

Role of insurance
Insurance needs to be considered as a separate process within a Risk Management system. This is
emphasised by the fact that the law governing insurance is separate from contract law and the contract
itself. For example, a contractor might have caused the loss and is the insured party, however in some
situations the Agency might still have strict common law liability for that loss.
All organisations need to determine how their risks will be financed if a loss does occur. The two main
options for financing a loss (i.e., that can be measured in monetary terms) are to ‘self finance’, i.e., to
absorb and budget for losses, or to transfer the cost to a third party, usually via an insurer at a known cost.
Insurance is the principle form of risk financing.
Usually organisations have a combination of both self-financed and insured risks. Sometimes there is no choice but to self-insure because commercial insurance is not available or the cost imposed by insurers is prohibitive or has onerous conditions, limits or excesses. (The latter in the insurance industry is known as the ‘deductible’).

The self-financing option is often chosen deliberately for two main reasons:

- If the organisation is usually a better than average performer, over the long run they might find it less costly to self-insure for non-catastrophic risks rather than pay a premium (i.e., a certain loss) to an insurer. The insurer needs to account for the expected performance of an entire pool of insured entities (including poor performers), administration costs and still maintain a profit.

- Having commercial insurance could encourage organisations to have lax processes in risk mitigation. It could be argued ‘why pay both the cost of being insured and the cost of mitigating loss occurrences?’

The TMF is a self-financing indemnity fund. It is not an insurer, as it is not governed by the Insurance Act. In addition, the indemnity cover provided by TMF is extremely broad and is not subject to restrictive conditions usually found in an insurance policy.

# Uninsured contractor

**Key risks**

The Agency is unable to recover costs from insurance, from their own insurances or those of the contractor. The Agency could be adversely affected in four ways:

- The Agency being liable for uninsured losses of the contractor that were caused by the contractor.

This could occur, for example, if an employee of the contractor is injured on the job and the contractor has no Workers’ Compensation Insurance;

- Third party liability.

Payment is made by the Agency to a third party where the loss to persons or property, resulted from the act or omission of the contractor;

- Damage or injury by contractor to Agency’s property or staff;

- Adverse impact on contract works and hence also Agency operations.

The Agency’s operations are adversely impacted due for example, to the contractor being unable to continue work because of their inability to pay for the cost of lost or damaged equipment.

The insurances could either have been required by the Agency – but did not exist, or otherwise was not required but should have been.

**Under-insured contractor**

A contractor is not fully insured for the insurable loss and the Agency bears the residual loss. In most cases this could be due to lower than necessary policy limits including the aggregate limit or sub-limit for a particular insurable risk. An inadequate analysis of the maximum reasonable exposure and/or likelihood is the likely cause of this problem.
In addition, if the policy has a ‘averaging’ clause, contractors could be underinsured even if the loss amount is within the limit. Averaging clauses require the total potential loss to be declared and insured. Not doing so, by for example only taking cover for 60% of the full exposure could result in any claim being limited to 60% of the actual loss.

**Contractor breach of insurance policy or condition**

A contractor’s claim for insurance is invalid due to a breach of a general policy term, or violation of a specific condition of cover. This highlights the importance of distinguishing between a valid insurance policy and a valid claim.

**Excessive insurance requirements by Agency**

If an Agency demands excessive levels of insurance, the contractor is likely to respond in one of three ways, by:

- Requiring a higher than necessary contract price. This occurs when a contractor is able to build the additional insurance costs into the contract price.
- The number of tender applicants is narrowed to the point where the tender process becomes uncompetitive.
- This might occur because contractors that might otherwise apply would be unable to obtain the onerous insurance requirements, or to do so would not be cost effective.
- The contractor accepts the contract but continuously looks for shortcuts, seeks variations and produces outcomes that just meet the main contract conditions.

The above risks can also apply to Agencies that have their own insurances.

**Types of insurance policies**

The law requires Workers’ Compensation insurance. Otherwise the required insurance and extent of cover depends on the circumstances and is best ascertained from a risk assessment. The most likely, (but not necessarily the most important) insurances are:

- Workers’ Compensation insurance (a statutory requirement).

This insurance is effected from the State or Territory in which the work is undertaken.

- Public Liability insurance.

This covers personal injury, other health impacts and property damage to third parties arising from the contractor’s business activities.

- Motor vehicle – third party property damage cover for registered motor vehicles.

In addition, depending upon the nature of work undertaken and the assessed risk exposure; the following insurances need to be considered:

- Product Liability insurance.

Covers the liability of contractors for bodily injury or property damage caused by a ‘defective’ product. The injury or property damage could be to the Agency, Agency employees, or customers of Agency services from defects in products that a contractor provided to the Agency. It also covers the liability of a
contractor, after completion of a job as a result of improperly performed work (also known as Completed Operations insurance).

The history of losses indicate that the main causes fall into the following categories:

- Negligent design;
- Failure to adequately test;
- Failure to provide adequate instructions, warnings and labels;
- Failures to issue adequate recall notices.
- Professional Indemnity insurance (PI).
- Depending upon the particular policy, PI insurance usually includes cover for acts, errors or omissions during the professional conduct of a contractor’s work.
- The cover can include compensation for dishonesty (other than directors’ dishonesty); bodily injury; personal injury and/or property damage, and can include defamation.

Typically, the types of activities requiring this cover are if the contractor, subcontractor, design consultant or any consultant provides:

<table>
<thead>
<tr>
<th>Activity</th>
<th>Example</th>
</tr>
</thead>
<tbody>
<tr>
<td>Design services</td>
<td>Technology and complex building structures</td>
</tr>
<tr>
<td>Advice</td>
<td>Where such advice is materially important, such as findings and recommendations for OHS studies and the environment</td>
</tr>
<tr>
<td>Training</td>
<td>Such as OHS and technical training</td>
</tr>
<tr>
<td>Management service</td>
<td>Such as project management services</td>
</tr>
</tbody>
</table>

- Contract Works: - cover for physical damage or loss a particular work during the construction phase.
- Industrial Special Risks (‘ISR’)- as for contract works except covers completed works.
- Advance Business Interruption.

Otherwise known as Consequential Loss insurance, these policies respond to financial loss suffered by contractors due to physical loss, damage or as a result of a delay in the commencement date of a project. The financial loss covered could include holding costs, rent receivable, and gross profit and development costs.

It is important for Agencies to determine if they require this insurance to include financial loss paid to the Agency as a result of losses incurred by them, and allowed by contract terms. A common example is for liquidated damages.

This insurance is usually effected with the same insurer as the construction contract risks policy.

- Suppliers’ Contingency insurance.
A variant to interruption insurance where cover is provided to a contractor for the financial impact on the works due to either:

- Failure of a supplier to supply due to damage to their property or premises,
- or
- Damage to the supplier’s materials, goods or services on the customers premises (i.e., at Agency’s premises).

This insurance is sometimes found as an extension to ISR insurance.

- Inherent Defects insurance.

This could last for 6 to 10 years and covers the premises against any damage consequent upon an inherent defect in the structural works of a building.

**Examples of other insurance policies**

Marine transit; Directors and Officers; Personal Loss or Injury for Volunteers, and Mechanical breakdown.

**Possible controls for insurance risks**

Some requirements in a contract, or in managing insurances include the following:

- Ensure that the required contractors insurance provisions are consistent and compatible with indemnity clauses in the contract.

This is essential. In particular, the amount of indemnity provided by the contractor in the contract must exceed the maximum reasonable total insurance loss scenario set out in the contractors insurances.

- Agency to approve insurers.
- Contractor to prove insurances.

Contractors must be required to show evidence of the insurances, such as a Certificate of Currency, and confirm that they are current. If not, payment to contractor can be withheld if proof is not supplied and the Agency has the right to effect the insurances and charge the contractor for the premium cost.

- Contract indemnity clause must cover the types of insurance losses and loss limits required by insurance (also see 10.3 in this document).

Not doing so could mean that the contractor is only contractually liable for payment from the contractor (or their insurer) to the level of the indemnity limit.

- Agency as an additional named insured.

Claims for general insurances need to be in joint names with the ‘Interests of (Agency name) as an additional named insured’.

Doing so provides an Agency with the right to claim under the policy when the contractor causes:

- Loss or damage to Agency property;
- Injury or illness to Agency staff; or
- Where a third party claims against the Agency due to a negligent act or omission of the contractor, its employees, agents or subcontractors.
• Cross Liability and Waiver of Subrogation Clause (Used where Agency is an additional name insured). This clause ensures that:

The cross liability clause recognises at least two named insured, but only one limit of liability exists for any one incident; and

The waiver of the normal insurance right of subrogation, means that the insurer cannot seek recovery from the Agency of claim sums already paid to the contractor.

• Cancellation clause.

Include in the contract a requirement that the contractor’s insurance policy is to include an undertaking by the insurer to provide the Agency of a notice in advance of any cancellation. This requirement should then be confirmed in the contractor’s policy documents.

• Period of insurances.

A minimum of the contract term, including any warranty/maintenance/service period and at completion of remedial work for any defects.

• The exception is PI insurance, which could extend from 2 to 7 years following completion. PI insurance policies are claims made policies: meaning the claim arises at the date the claim is made that could be after the date the incident occurred. Agencies must monitor continuation of PI insurance where the risk is materially important and ensure they have the right to do so in the contract.

• Require liability insurance to be in ‘broad-form’.

This ensures that the policy is not only restricted to a easily definable accident, but also any occurrence, including product liability and repeated exposure to adverse conditions that might over time result in damage or have adverse health impacts.

• Principal (i.e., Agency) controlled insurance: - for large construction works:

It might be useful for some Agencies, particularly for large construction projects, to arrange the insurances required for both construction risks and third party liability and recover the costs in doing so (in accordance with contract terms) from the principal contractor. Many of the risks, such as laping cover and inadequate cover could be more easily managed particularly when there are a large number of contractors’ and subcontractors’.

This method of managing insurance risk does not apply to all types of insurances. Professional Indemnity is an example.

Other transfer risks

Contracts usually have clauses that attempt to eliminate, reduce or transfer risks by specifically defining liabilities E.g., by indemnities. Those clauses might not be legally enforceable, or if so, might not be adequate in recovering losses, or effective because the contractor has not the means to meet the legal obligation.

In addition to insurance, risks in adequately transferring liability include:

• Inadequate, or ineffective exclusion clauses;

• Force majeure;
• Inadequate indemnity and liability.

Inadequate, or ineffective exclusion clauses

Agencies could be at risk for not having appropriate exclusion clauses. Alternatively, there is the risk that unlawful actions are taken in the misguided belief that they will be a valid defence against key contract conditions or common law obligations.

Agencies could include in their contracts exclusion clauses designed to reasonably limit their exposure to contract liability. A typical exclusion clause might say:

"... you exclude us from all responsibility for damage to your property on our premises caused by any person"

However, merely having exclusion clauses will never allow Agencies to fully avoid being held liable for the Agency’s actions or omissions during the contract process. In the case of misleading conduct and estoppel, exclusion clauses have little or no effect. In other cases, exclusion clauses can be struck-out as being unconscionable or as misleading and deceptive.

It might be appropriate to exclude certain obligations that could be implied in contracts that might otherwise make an Agency committed to a situation that is not in their best interests to do so. This is particularly the case in Requests for Tenders. For example, it might be useful to make it clear that the tender does not require a contract to be provided to the lowest bidder, or indeed to any applicant, so long as no bidder meets the required criteria.

However, disclaimer clauses do not allow an Agency to avoid observance of the agreed tender. Nor do they over-ride common law requirements to treat the parties fairly and to act in good faith.12 Exclusions are unlikely to be effective in allowing the abandonment of a tender merely because of a change of mind on the need to acquire a service or product, or project. Hence Agencies have the two risks: abandonment of tender and contract rescission, which could result in payment of costs to tender applicants, and both costs and loss of profits to a contractor.

Possible controls

• The risk of being liable for costs from abandoning a pre-award tender could be alleviated by ensuring that it was never a contract and saying that ‘the Request for Tender (RFT) is not intended to give rise to any contractual obligations’.

• However, as explained earlier, no disclaimer clauses are effective against misleading conduct or estoppel. To be effective, the exclusion clause must be clear and consistent with other terms in the RFT or main contract.

• In general, use exclusion clauses where possible but don’t rely on them to avoid your contract requirements or duty of care responsibilities.

Force majeure

Translated literally, ‘force majeure’ means ‘superior force’. It is better known in contract terms as essentially all causes beyond the reasonable control of either party that could, at the option of the affected

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12 see the NZ case, Pratt contractors Ltd v Palmerston North City Council. (1995) 1 NZLR 469
party, allow them to be excused from fulfilling the contract. ‘Force majeure’ might lead to the temporary suspension of a contract or contract termination.

Invoking ‘force majeure’, even for the most acceptable reasons is a risk in itself. Typical examples are a critical change in the law banning the specific service or product, or a major natural catastrophe such as a flood.

Example

Contract works stop as a result of a strike by a key subcontractor. The strike arose due to a dispute between them and the principal contractor. The principal contractor fears the potential of incurring high costs imposed by the Agency according with liquidated damages clauses in the contract. In defence, the contractor successfully invokes the ‘force majeure’. The contractor is able to discontinue the contract without penalty, or after much delay re-negotiates the contract while seeking alternative arrangements.

Contract terms need to specify the process so that both sides can adjust their interests in a mutually satisfactory manner. The greatest controllable risk relating to ‘force majeure’ from the purchasers’ viewpoint is having an unnecessarily wide definition in the contract or not adequately defining its meaning and implications.

Inadequate indemnity and liability

The key danger is accepting limits to liability below the maximum reasonable loss. The other related critical factors are the contractor’s financial ability to pay (see 6.12 Contractor insolvency), and the adequacy of insurances for insurable risks (see 9, Insurances).

Contracts almost always have a standard indemnity and liability clause. The clause needs to be comprehensive. It could state that the contractor is liable for and indemnifies the principal against loss or damage whatsoever arising from the work to all property (of all types) including property adjoining the area impacted by the work and of all persons for personal injury, adverse health impacts or death.

An inadequate indemnity is likely to arise when contractors negotiate or demand a limit to the indemnity. Accepting limits to liability should be avoided if possible. However, if it is absolutely necessary to do so, i.e., they are the only contractor capable of doing the work, then the Agency will need to make an assessment of a reasonable limit.

It is extremely dangerous to link a limit of indemnity to the size or term of the contract. For example, an error in a small ‘hot works’ contract in a major public building such as the NSW Art Gallery or State Library could result in financial losses of billions of dollars.

Possible controls

- Liability and indemnity requirements should be unlimited.

In practice this is difficult to achieve. When this is not possible, a determination of maximum reasonable loss needs to be calculated. This could include:

  - The cost of property at replacement values;
  - Where applicable- demolition, excavation and remedial work;
All consequential losses, i.e., financial impact in terms of loss in income/profits and increased costs on the Agency, Agency’s clients or third party businesses.

- Term of indemnity could cover all activities and post-completion defects or adverse impacts.

The term of the indemnity could extend beyond practical completion to any defects or maintenance period.

- Include and define the meaning of counter indemnity.

This might assist in clarifying responsibility in situations where both the Agency and contractor have contributed to the cause of the loss or damage.

Managing contract liability risks

A principal to a contract can be liable for loss, damage or injury in many ways. Generally an Agency in the capacity of a principal could be liable if:

- The Agency assumes the contractors obligations due to the nature of the work relationship or because the contractor does not have statutory insurance.

- The contractor/subcontractor causes the loss but the Agency assumes liability because their duty of care extends to aspects of the contractor’s activities.

Example 1: A client or third party sues the Agency for an injury incurred as a result of a contractor action while on the Agency’s premises;

Example 2: A waste removal contractor dumps Agency waste on an unlicensed site.

- The Agency is negligent, either by their acts or words:

If it is by their acts it is likely to result in personal injury or property damage. If it is by negligent words the result is usually financial loss. An example of an Agency act might be failure to advise a contractor or subcontractor of a hazardous site condition that causes the contractor to lose or damage property, or injure themselves or other parties.

- Liability could be apportioned between the principal and contractor. Usually this occurs due to causation from both parties.

An extreme case, is where an Agency is jointly and severally liable with a contractor. It is possible that the party who was adversely affected could choose to hold the Agency fully liable because they know the Agency has the greater capacity to pay. Furthermore, if the contractor lacks the financial capacity or insurances, any right that the Agency might have to recover the contractor’s contribution or indemnity might not be supported by any practical means.

In addition to liabilities to the Agency, liability can extend to directors and managers of the Agency in accordance with certain legislation, such as the OH&S Act. Agencies have a duty to provide a safe environment for all persons (i.e., employees and others) in the work place is required by the OHS Act (2000). [See Part 2 – Division 1, of the Act]. In some cases strict liability can apply that makes it very difficult to mount any defence. This means that unlike common law, the damage does not need to be foreseeable, the duty applies irrespective of any care being taken, or if there is was no intention to mislead. Strict liability applies for example in the Trade Practices Act.
In conclusion, legal liability could arise in accordance with specific contract terms, common law liability and/or liabilities attributed to various legislative requirements. Many risks already mentioned in this paper have, or could have, liability impacts for Agencies. Some further specific liability risks are described overleaf.

**Contractor is deemed an ‘employee’**

Agencies could inadvertently be deemed to be an employer, for the purposes of certain Acts, when contractors act as individuals. This might arise irrespective of the contract terms because of the nature of the practical working relationship. The consequences for an Agency are that they might be liable to pay the contractor’s PAYE tax, Worker’s Compensation and Superannuation.

**Possible controls**

Agencies should take care not to provide substantial equipment and tools, providing for their insurances, and paying them in the form of salary or wages, or doing anything else that could be considered as normal in an employer/employee relationship.

**Contractor injury (without worker’s compensation insurance)**

If a contractor is without worker’s compensation insurance an Agency might be liable to meet any worker’s compensation claim by an employee of the contractor.

Consequently, as explained in the section on Insurances it is necessary to ensure that this insurance is effective before and at all times during the contract.

**Major public liability claim on Agency (incident ‘caused’ by the contractor)**

This is a major risk. There is always the potential for a major claim on Agencies from contracting activities. This could include contracts to sell product (see Product Liability (7.4)), or engaging contracted services. In either case the Agency might not have ensured that they or the contractor had adequate processes, such as appropriate controls and monitoring. A major claim could result from a class action or separate and many actions for damages.

**Example 1: (where Agency responsibility cannot be delegated)**

A country area health service contracts with a food manufacturer to provide ‘cook-chill’ meals to the district hospital. The contractor’s long-term chef leaves and with him went many critical safety procedures that were never written down or monitored either by contractor management or the Agency. The new chef fails to apply appropriate procedures resulting in the hospital receiving contaminated food and the death of patients who were elderly or had deficient physical immune systems.

NSW Health is held liable for damages related to severe adverse health impacts and loss of life.

**Comment**

In this example, an employee of the contractor and not the contractor had the necessary quality processes. Consequently, the performance of the contractor appeared to be acceptable when in fact the contractor had a non-existent and non-sustainable food safety system.
Example 2 (where an Agency contributes to the cause)

A road works contractor to the Roads and Traffic Authority (RTA) incorrectly placed traffic warning markers according to the prescribed procedures. As a result a vehicle driven within the speed limit fails to take a turn and an accident leaves the driver with severe and permanent disabilities. The solicitor for the contractor obtains evidence that the speed limit signs positioned by the contractor, but authorised by RTA, exceeded RTA’s recommended speed limit for those circumstances. A court then apportions 80% of the damages to the plaintiff to be paid by the RTA.

Possible controls

Consider liability impacts with all risks

Because liability impacts are often very unpredictable, large and can derive from so many activities and risk scenario’s, it might be more appropriate to ensure that the potential for liability consequences are considered with all risks. This means that liability consequences are a standard consideration in the risk assessment process for all risks rather than merely listing possible ‘liability risks’.

<table>
<thead>
<tr>
<th>Monetary cost to Agency</th>
<th>Legal liabilities as below</th>
</tr>
</thead>
<tbody>
<tr>
<td>People</td>
<td>Serious injury</td>
</tr>
<tr>
<td>Environment</td>
<td>Not applicable</td>
</tr>
<tr>
<td>Legal liability</td>
<td>Compensation claims for injury or property damage</td>
</tr>
<tr>
<td>Public perception</td>
<td>Local media coverage</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Likelihood</th>
<th>Comment: Significant- supported by history and inherent risk factors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Resulting risk level</td>
<td>Significant</td>
</tr>
</tbody>
</table>


Appendix 10: Bibliography


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