



## Brief 22

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### Public Procurement

# Contract Management

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## Introduction

When a contracting authority enters into a contract with an economic operator, the arrangement cannot just be left to run its course, it must be managed so as to enable both the contracting authority and the economic operator to meet their contractual obligations. Contracts are frequently complex, may involve multiple actors, may last a long time and may consume many resources. It is therefore vital that they are properly managed.

If an economic operator realises that the contracting authority is not monitoring progress, it may get careless and delivery will be less than acceptable, or it may create and demand variations that are not provided for in the contract.

## Process of contract management

Contract management activities can be broadly grouped into three areas: delivery management, relationship management, and contract administration.

- **Delivery management** ensures that whatever is ordered is then delivered to the required level of quality and performance as stated in the contract. Delivery management may include checking the nature, quantity and quality of:
  - goods supplied – on delivery and also, when appropriate, at the time of manufacture;
  - works carried out – including conformity with designs and drawings, quality of workmanship and materials;
  - services performed – including checking that required service levels and timescales are met.
- **Relationship management** seeks to keep the relationship between the economic operator and the contracting authority open and constructive, with the aim of resolving or easing tensions and identifying potential problems at an early stage, while also identifying opportunities for improvement. Relationships must be wholly professional throughout and must include a professional approach to managing issues and dispute resolution.
- **Contract administration** covers the formal governance of the contract and any permitted changes to documentation during the life of the contract. This area of contract management ensures that the everyday aspects of making the contract run effectively and efficiently are taken care of.

## Contract management in practice

**Managing the relationship:** Contractual arrangements create a relationship between the contracting authority and the economic operator that inevitably involves a degree of dependency. It is in the contracting authority's own interest to make the relationship work, as the costs of early termination and the consequences of poor performance and unplanned changes of economic operator are highly damaging. The three factors for success are:

- mutual trust and understanding;
- openness and excellence of communication;
- a joint approach to managing delivery.

This Brief provides a summary of contract management processes over the life of a major contract. It is illustrative but not exhaustive; some processes may not be necessary for all

contracts, while others, although important in some situations, may not be covered here, as what is relevant depends on the nature of the contract being managed.

**Inaugural or initial meeting:** For any major contract it is good practice to have a formal inaugural meeting soon after the contract has been officially awarded. This meeting allows people from both the economic operator and the contracting authority to meet for the first time within the context of the agreed contract. They may have met before, but that contact would have been while the parties were going through the procurement process. At this meeting it is vital that both sides move from a competitive to a co-operative viewpoint – they will be working together for the life of the contract, as both will want to achieve a successful outcome. The objectives of the meeting include:

- understanding the roles and responsibilities of everyone present;
- discussing the implementation and/or project plan;
- discussing issues that impact on the operation of the contract;
- discussing control mechanisms.

Although this meeting is important for relationship management, it must not become an opportunity to make changes to the specifications or other requirements or to the conditions of the contract. Where absolutely necessary, these issues would have been dealt with in accordance with pre-agreed procedures set out in the contract established for this purpose and in compliance with the contract modification provisions permitted by the Public Sector Directive<sup>1</sup> (see below).

**Ongoing contract management:** The economic operator will carry out the contract within the agreed scope. This may include the delivery of goods and materials or the provision of services or works to the contracting authority. A vital function is to allow each party to raise issues as soon as they are identified so that the other party may treat these issues seriously and promptly. Ongoing contract management includes the administration of a range of activities, including the following:

- change control
- charges and cost monitoring
- ordering procedures
- receipt and acceptance procedures
- payment procedures
- budget procedures
- resource management and planning
- operational and management reporting
- asset management
- progress meetings.

Contracting authorities are advised to have standard procedures in place for the above activities and to seek advice from other competent authorities in the case of large or complex contracts for which standard procedures may be insufficient or inadequate.

**Issues log:** An issues log is a useful mechanism for recording and managing issues arising during contract implementation. It records issues as they arise along with the actions taken to

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<sup>1</sup> Directive 2014/24/EU on public procurement and repealing Directive 2004/18/EC, 26 February 2014.

attempt to address them. A dispute resolution procedure must be provided for in the contract for issues that cannot be resolved in this way.

**Review meetings:** Review meetings between the parties to the contract are another practical means of keeping control of a contract, particularly when it is complex or runs over several years. The frequency and coverage of review meetings, if any, will depend on the nature of the contract. Review meetings are a useful means of communication between the parties to the contract during its execution, and negative consequences may result from not having them. The meetings must be well prepared, focused and not too time-consuming.

Review meetings are intended as a forum for the parties to the contract, and not for other beneficiaries or stakeholders. In some cases, such as major infrastructure projects, other beneficiaries or stakeholders may need to be consulted or informed about the ongoing delivery of the project. This process is separate from the review meetings.

**Contract performance controls:** Control is vital but is impossible without measurement. Therefore, clear and effective contract performance measurement is essential. Controls must be:

- highly relevant to the essence of the contract;
- understood and accepted by the economic operator and the contracting authority;
- measurable;
- robust in their operation;
- dependable in providing more value than costs;
- able to reflect soft and hard measures;
- resourceful in providing useful information.

Timely reporting at a high and/or summary level is much more effective than accurate late information. It is essential for the information obtained to be useful, either intrinsically or because it can be processed to provide knowledge on which to base decisions and activity. Procurement officers are advised to have a small number of effective controls rather than a large number of controls that are only carried out because it is possible to obtain and report the information.

Contract performance controls need to be considered and devised at an early stage of the procurement process, when determining the needs and deciding the outcomes of a contract before it is procured. See SIGMA Public Procurement Brief 21, *Performance Measurement*, for further discussion and examples.

**Service-level agreements:** Service-level agreements are an excellent way of ensuring control of contracts. By clearly stating the required and agreed quality and delivery requirements of services, both the contracting authority and the economic operator know and understand what targets have to be met in the delivery and support of services. Similar approaches can be applied to the performance of equipment or facilities, where the requirements may be expressed, for example, in terms of processing capacity, availability, average time between technical problems, or consumption of energy. A detailed agreement should be established of the required service levels and thus of the expected performance and quality of services to be delivered as well as the consequences of poor performance. These requirements are incorporated into the contract (often in schedules) and feed into the performance measurement controls. As with performance controls, these service levels should be determined at an early stage in the procurement process, when various alternatives and their costs and benefits are examined and a decision is taken on what is to be required from the tenderers and, ultimately, the contractor to be engaged.

**Risk and risk management:** Risk can be defined as the uncertainty of outcome, whether a positive opportunity or a negative threat. In the area of contract management, the term “management of risk” incorporates all of the activities required to identify and control the risks that may have an impact on the fulfilment of a contract.

Many risks involved in contract management relate to the economic operator being unable to deliver at all or not delivering at a satisfactory level of quality.

These risks could include:

- the economic operator’s lack of capacity;
- the economic operator’s key staff being re-deployed elsewhere, eroding the quality of the works delivered or the services provided;
- the economic operator’s business focus moving to other areas after the contract award, reducing the added value for the contracting authority in the arrangement or impacting on the timeliness of delivery of goods or works;
- the economic operator’s financial standing deteriorating after the contract award, eventually endangering its ability to maintain the agreed quality requirements of the goods purchased or the level of services;
- demand for the goods or services being much greater than expected and the economic operator being unable to cope;
- demand for a service being too low, meaning that economies of scale are lost and operational costs are disproportionately high;
- staff at the contracting authority with knowledge of the contract transferring or moving on, weakening the relationship;
- factors beyond the economic operator’s control disrupting the delivery of goods or services, for example premises that cannot be accessed due to a natural disaster;
- the contracting authority’s inability to meet its obligations under the contract.

Perceived or anticipated risks should be identified in advance when preparing the procurement, and they can then be addressed in the contract documents, with a clear and appropriate allocation of responsibility and a corresponding acknowledgment and understanding of the consequences.

One factor that can help procurement officers in a problematic case is the relationship that they have with the economic operator. Where the relationship is good, open, fair and honest, an early warning of the realisation of an identified risk may be provided through the normal working relationships and control mechanisms. Where the relationship is poor, the economic operator may attempt to hide the problem, which then normally materialises as a greater risk.

**Modifications:** The contract terms and conditions should include mechanisms to cope with permitted modifications during the life of the contract. Currency fluctuation clauses and price indexation clauses are common examples where the need to make a modification can be foreseen and accommodated within the contractual terms.

Contracting authorities must be very careful when considering the possibility of modifying an agreed contract, particularly outside a pre-agreed and transparent contractual cost modification mechanism. There is a significant danger that the modification of a contract could result in the award of a new contract, unless one of the limited exceptions applies. If the modifications are substantial and amount to the award of a new contract, then this new award must be in compliance with the Public Sector Directive. A failure to comply with the provisions

of the Public Sector Directive, Utilities Directive<sup>2</sup> or Concessions Directive<sup>3</sup> where the modifications amount to the award of a new contract may be regarded as an illegal direct award. For more information on contract modifications, see SIGMA Public Procurement Brief 38, *Contract Modifications*.

It is in the very nature of some, widely-used standard contracts, particularly for works, that they have clear and comprehensive provisions allowing the contracting authority to change the nature, quantity and quality of the subject of the contract. From a contract management point of view, it is advantageous to be able to address changing circumstances as they arise during the execution of the contract in a transparent, timely and efficient manner. This is a good reason for using this type of contract, but it is important that the contracting authority has thoroughly prepared the scope of the contract and worked out a sound, detailed and robust design, so that the possible variations are minimised. If this is not possible, then a different procurement and contracting strategy should be used. Failure to do so may not only lead to the procedural and legal problems referred to above but may also call into question the integrity of the parties and the procurement process itself.

**Payment:** The payment of economic operators is a control in itself, but the power that contracting authorities have at this stage of the procurement process must not be used to unjustly delay or withhold payment to economic operators that have completed the work. To do so would damage the relationship between the economic operator and the contracting authority. Seen from a contracting authority's perspective, the payment process has three stages:

- 1) receipt of request for payment;
- 2) matching and authorisation;
- 3) transfer of funds.

If an option for direct payment to subcontractors is provided by the national legislation of a Member State, contracting authorities must take this option into consideration in the payment process.

**Matching** includes verification that the payment corresponds to the order and to the terms and conditions of the contract and that the goods, works or services have actually been provided – as evidenced by the contract performance controls.

**Close out:** The objective of the close-out phase is to ensure that the contracting authority is satisfied with the delivery of the goods, works, materials and services that it has purchased. Close-out will frequently tie in with post-contract review and with continuous improvement of the whole procurement process. It may involve both the person who ran the procurement and the person who managed the contract as well as independent reviewers. It provides the opportunity to identify how well the contracting authority's contract and procurement teams have performed on the project as well as to review what lessons have been learned for the future.

A contract may not necessarily be considered as concluded when the actual physical work has been completed or the goods delivered. The true end of the contract may be the end of a warranty, retention or defects liability period. However, there are several stages to be covered before that point is reached. Not all of these stages will be necessary with every procurement exercise, and contracting authorities must select a process that meets the particular requirements of the contract.

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<sup>2</sup> Directive 2014/25/EU on procurement by entities in the water, energy, transport and postal services sectors and repealing Directive 2004/17/EC, 26 February 2014.

<sup>3</sup> Directive 2014/23/EU on the award of concession contracts, 26 February 2014.

Concluding stages leading up to close-out may cover, for example:

- Joint inspection of the completed requirement.
- **Snagging list:** During the inspection, the group will draw up a “snagging list”. Snags are minor deficiencies that do not have a major impact on the functionality of the finished requirement or service delivery. The snagging list is issued to the economic operator, and realistic dates are agreed for the resolution of the snags. Examples of items on a snagging list are the following:
  - typographical errors on documents provided by economic operators;
  - windows that do not close on a building;
  - a list of improvements from participants on a pilot training programme;
  - software screens that do not clear properly and present new data.
- **Final documents completed and stored:** With any procurement, but particularly for works contracts, it is vital that complete records are kept of all of the diagrams, specifications, lists, data files, drawings and documents that describe all of the requirements in the original contract and any agreed changes to them, as well as the characteristics of what has actually been provided, for example the “as-built” drawings for a works contract. There are two reasons for this requirement: (1) the economic operator must be able to manage any actions necessary under the warranty, retention or defects liability period; and (2) the contracting authority must have a full set of information about the detailed design and specifications to ensure that the works are properly maintained, and if any modifications are subsequently required, full information is available on which to base the amended design. In some sectors there may be statutory requirements to maintain detailed records for the lifetime of the plant until final decommissioning.
- **Commissioning and testing completed:** Where necessary, commissioning and testing should form an integral part of the process of transferring ownership to the contracting authority of the works (building or bridge), equipment (vehicle, computer system or photocopier), or services (vehicle or aircraft service). The purpose of this process is to eliminate initial problems in the operation of the requirement so that it is fit for the purpose for which it was originally specified. For complex projects, sometimes an independent commissioning engineer may be used to undertake this process with both parties.
- **Handover/contracting authority acceptance:** This is a formal procedure for accepting the finished requirement from the economic operator, and documentation should include all of the testing and commissioning data, operation and maintenance manuals, and drawings.
- **Warranty, retention or defects liability period:** The terms and conditions of the contract will include a provision for a warranty, retention or defects liability period. This period will vary with the requirement and the specifications issued by the contracting authority. However, it will include the replacement of faulty parts or corrective action, as specified in the contractual document.
- **Issue of final certificate:** Where appropriate, a final certificate confirming the final completion of the project may be issued.
- **Final accounts agreed and payments made:** Once the final certificate has been issued, there should be no outstanding payments, and the procurement officer should check to ascertain that the final accounts have been agreed and all payments

have been made. The contracting authority may wish to check that the economic operator has paid the sub-contractors.

- Release of any performance bonds, retention monies or other forms of security.
- Formal end of the contract.

**Note:** Some contractual provisions, such as confidentiality agreements, may survive the formal end of the contract.

### **Post-contract performance review and continuous improvement**

Performance review is a comparison of the performance of the goods, works, materials and services against the quoted, specified and agreed criteria. As has already been pointed out, measurement is a vital part of the contracting process, but it is nevertheless sometimes forgotten once a contract has been completed and contracting authorities have moved on to another project. With a large procurement, a post-contract review is always an appropriate tool.

Continuous improvement involves looking at the procurement process and at the goods, works, materials and services bought and identifying areas for improvement that can serve for future procurement. The purpose of a post-contract review is to assess whether the procurement has delivered the benefits for which it was first conceived. It is also an opportunity to record lessons learned, capitalise on best practices, and record the performance of the economic operator and of the whole project management team for future reference, when a similar project may be undertaken.

## Further information

### Publications

SIGMA (2015), *Public Procurement Training Manual* – Module G, OECD Publishing, Paris,  
<http://www.sigmaweb.org/publications/public-procurement-training-manual.htm>

### Public Procurement Briefs

<http://www.sigmaweb.org/publications/key-public-procurement-publications.htm>

SIGMA (2016), *Performance Measurement*, Brief 21, OECD Publishing, Paris