Paymech model proposal for accredited programmes and unpaid work contracts: GMPTC

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1. Purpose and structure of the document

1.1. This paper describes the recommended paymech model for the accredited programmes and unpaid work contracts. This is a target cost model with:

1.1.1. painshare or gainshare if actual costs differ from target costs;
1.1.2. a maximum price above which costs will no longer be reimbursed; and
1.1.3. profit / surplus dependent on performance and quality levels being achieved.

1.2. The first section describes the different service elements to be used for payment purposes.
1.3. The next sections describe the operation of the proposed model.
1.4. Finally, there are some scenarios which illustrate how the model will work in different scenarios
    of low, medium higher than expected cost and low, medium and high performance.
1.5. In some places, there are different options which could be applied or outstanding decisions. These
    are shown in blue text and any options described in more detail as relevant.

2. Payment elements

2.1. We propose the separate payment elements shown in the table below.

<table>
<thead>
<tr>
<th>Element</th>
<th>Unit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accredited programmes - BBR</td>
<td>TBC – starts of either groups or individuals</td>
</tr>
<tr>
<td>Accredited programmes - TSP</td>
<td>TBC – starts of either groups or individuals</td>
</tr>
<tr>
<td>Accredited programmes – other</td>
<td>TBC – starts of either groups or individuals</td>
</tr>
<tr>
<td>Accredited programmes – other</td>
<td>TBC – starts of either groups or individuals</td>
</tr>
<tr>
<td>Unpaid work</td>
<td>Hours delivered</td>
</tr>
<tr>
<td>Back office / fixed costs</td>
<td>No of requirements – two volume bands</td>
</tr>
<tr>
<td>Mobilisation, transition, transformation</td>
<td>One-off (target) cost</td>
</tr>
<tr>
<td>Optional services</td>
<td>Any costs which are over and above general back office costs can be simply added on with standard profit rate (outside of target cost)? And/or day rates to be provided for ad hoc work (e.g. analyst, project manager etc)?</td>
</tr>
</tbody>
</table>

3. Bidding and evaluation

3.1. The Authority will provide expected minimum and maximum volume points for each service
    element as part of the ITT, and a number of bands in-between.

3.1. Bidders will provide a target cost and for each band and a target profit / surplus level which will
    be applied to all elements and volume bands to give a target price for each element and volume
    band.

3.2. Although the Authority will provide expected minimum and maximum volume points for each
    service element, it could not provide any guarantees. Therefore, contracts will also set out how
    the price will be adjusted if volumes were outside of these ranges, within certain parameters.
3.3. Price evaluation will be based on the sum of the target prices across the full volume range of each element. The evaluation will also consider the logic and feasibility of resourcing and pricing models to ensure that realistic and deliverable bids are set at all volume points.

4. Change of volume band

4.1. The expected volume levels for each element for the following 12 months will be notified by the Authority on a rolling six months’ basis, to provide an updated expectation of which target cost and price band will apply for the coming periods. The expected volume band will be based on a flat forecast from previous actual figures (but without amending the band due to typical seasonal variations or short-term peaks and troughs) unless there was a sustained change in volume or a good reason to think there would be a sustained change (e.g. a policy change). The Authority will notify changes of applicable bands with six months’ notice for decreases and three months for increases to change the volume band and thus the applicable target cost and price. This accounts for the time taken to prepare for volume changes (such as recruiting or reducing staff). Some further consideration is required to define contractually when the Authority could and would use its discretion to set a volume band which was different to the historical trends, particularly in the case of a reduction not supported by recent trend data or a decision not to increase the band despite recent trend data.

4.2. Payment will be based on the Authority’s expected volume levels rather than actual volume levels, because the majority of cost is staff and it is difficult to adjust staff numbers without notice. Although there are some variable costs, these are limited and the nature of the target cost model and the cushioning means that there is in-built flexibility to cope with ongoing small fluctuations in volumes and thus costs, which are as likely to be higher than lower.

5. Setting GMP

5.1. The Authority will set a standard maximum price across all contracts, to be included in the ITT. This will be set at 20% above target cost, with allowable incurred costs always covered up to the guaranteed maximum price (GMP). This means a reasonable cushion is provided regardless of profit level set, to not disadvantage those bidding with lower target profit levels. We will review this percentage when the sensitivity analysis on the should-cost model has been carried out for the OBC.

5.2. Table 1 below shows an example bid profile for Contract Year 1. All figures are purely for example only and bear no relation to actual probation volumes or costs. Bidders will provide a similar table showing target costs and profit for each contract year. The Authority will then set the GMP based on the target costs. For this example:

- Target Price is set 5% above Target Cost
- GMP is set 20% above Target Cost.
6. Operation

6.1. Although a target cost and price will apply for each volume band of each element, the assessment of actual costs against target costs will be based on the aggregation of the target costs for all elements, except for mobilisation and transition.

6.2. Mobilisation and transition will be treated separately so that target profit for this element can be isolated, and will be awarded dependent on the achievement of transition milestones.

6.3. If actual (overall) incurred costs were higher than the target cost, the pain will be shared between the Authority and the supplier, and any incurred costs will be covered up to GMP. Up to a level of twice the amount of profit above target cost, the supplier could still make some profit (but see section 11 re deductions based on performance), but gradually reducing up to that point; between that point and GMP, no profit will be available, but costs will be covered.

6.4. If actual (overall) incurred costs were lower than the target cost, the gain will be shared between the Authority and the supplier.

6.5. An excess profit / surplus cap of 20% will be applied. This will be calculated purely on the costs reported, and agreed, for this contract, in relation to the target cost level (see also section 8 re unpaid work income). It will not consider any profits related to other income the organisation receives and it will be assessed pre-tax.

6.6. The Authority will try to keep any of the gains due to it, or any reductions in profit due to performance failures, to be available for innovation funding or additional services to be commissioned by the relevant regional Authority. However, as we could not guarantee that we will be able to use this money for such activities, we are not proposing the establishment of a formal innovation fund with some gains going into such a fund.

Table 1 (all figures purely illustrative and not based on actual probation volumes or costs)

<table>
<thead>
<tr>
<th>Cost Area/Block</th>
<th>Unit</th>
<th>Year</th>
<th>Min</th>
<th>Max</th>
<th>Target Cost</th>
<th>Target Price</th>
<th>Target Profit</th>
<th>Guaranteed Max Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accredited Programmes 1</td>
<td>Starts</td>
<td>1</td>
<td>0</td>
<td>9</td>
<td>£40</td>
<td>£42</td>
<td>5%</td>
<td>£48</td>
</tr>
<tr>
<td>Accredited Programmes 1</td>
<td>Starts</td>
<td>1</td>
<td>10</td>
<td>19</td>
<td>£50</td>
<td>£53</td>
<td>5%</td>
<td>£60</td>
</tr>
<tr>
<td>Accredited Programmes 1</td>
<td>Starts</td>
<td>1</td>
<td>20</td>
<td>40</td>
<td>£60</td>
<td>£63</td>
<td>5%</td>
<td>£72</td>
</tr>
<tr>
<td>Accredited Programmes 2</td>
<td>Starts</td>
<td>1</td>
<td>0</td>
<td>9</td>
<td>£40</td>
<td>£42</td>
<td>5%</td>
<td>£48</td>
</tr>
<tr>
<td>Accredited Programmes 2</td>
<td>Starts</td>
<td>1</td>
<td>10</td>
<td>19</td>
<td>£50</td>
<td>£53</td>
<td>5%</td>
<td>£60</td>
</tr>
<tr>
<td>Accredited Programmes 2</td>
<td>Starts</td>
<td>1</td>
<td>20</td>
<td>40</td>
<td>£60</td>
<td>£63</td>
<td>5%</td>
<td>£72</td>
</tr>
<tr>
<td>UPW</td>
<td>Hours</td>
<td>1</td>
<td>15,000</td>
<td>19,999</td>
<td>£90</td>
<td>£95</td>
<td>5%</td>
<td>£108</td>
</tr>
<tr>
<td>UPW</td>
<td>Hours</td>
<td>1</td>
<td>20,000</td>
<td>24,999</td>
<td>£100</td>
<td>£105</td>
<td>5%</td>
<td>£120</td>
</tr>
<tr>
<td>UPW</td>
<td>Hours</td>
<td>1</td>
<td>25,000</td>
<td>29,999</td>
<td>£105</td>
<td>£110</td>
<td>5%</td>
<td>£126</td>
</tr>
<tr>
<td>UPW</td>
<td>Hours</td>
<td>1</td>
<td>30,000</td>
<td>35,000</td>
<td>£110</td>
<td>£116</td>
<td>5%</td>
<td>£132</td>
</tr>
<tr>
<td>Back Office</td>
<td>Active Cases</td>
<td>1</td>
<td>500</td>
<td>1,399</td>
<td>£100</td>
<td>£105</td>
<td>5%</td>
<td>£120</td>
</tr>
<tr>
<td>Back Office</td>
<td>Active Cases</td>
<td>1</td>
<td>1,400</td>
<td>2,000</td>
<td>£150</td>
<td>£158</td>
<td>5%</td>
<td>£180</td>
</tr>
<tr>
<td>MTT</td>
<td>N/A</td>
<td>1</td>
<td></td>
<td></td>
<td>£100</td>
<td>£105</td>
<td>5%</td>
<td>£120</td>
</tr>
</tbody>
</table>

Total (of selected volume)   | 1      |      | £400 | £420  | 5%          | £480         |

6.6.6. The Authority will try to keep any of the gains due to it, or any reductions in profit due to performance failures, to be available for innovation funding or additional services to be commissioned by the relevant regional Authority. However, as we could not guarantee that we will be able to use this money for such activities, we are not proposing the establishment of a formal innovation fund with some gains going into such a fund.
6.7. The graph below shows a range of scenarios, described below the graph, which apply with different levels of actual costs in relation to target costs. Please note it does not include any profit cap.

Scenario 1
If IC < TC
Actual payment = TP - ((TC-IC)/2)
When Incurred Costs are lower than Target Cost, there is gain share i.e. half the difference between Target Cost and Incurred Cost is taken off the Target Price, meaning efficiency gains are shared with the authority.

Scenario 2
If IC > TC and
TP + ((IC-TC)/2) > IC
Actual Payment = TP + ((IC-TC)/2) (Capped at GMP)
When Incurred Costs are greater than Target Cost there is a pain share. i.e. half the difference between Target Cost and Incurred Cost is added to the Target Price so the supplier still makes a (reduced) profit.

Scenario 3
If IC > TC and
TP + ((IC-TC)/2) < IC
Actual Payment = IC (Capped at GMP)
When Incurred Costs are greater than twice the difference between Target Cost and Target Price, the authority will still pay all Incurred Cost up to the Guaranteed Max Price. Only when Incurred Costs are higher than GMP will the supplier begin making a loss.
7. **Payment, reconciliation and open-book accounting**

7.1. Based on the notified expected volume level, the target price will be paid at the end of each month in line with usual invoicing procedures and timescales.

7.2. Mobilisation and transition costs will be included in the target cost for the year, but they will be paid when they were due to fall for the period of the actual MTT process (which might differ by supplier in length and profile).

7.3. Reconciliation of actual costs against target costs will only happen annually, due to the potential fluctuations in costs during the year. However, suppliers could at any time during the year request additional funds if their actual costs were consistently higher than their target costs, and it will be at the Authority’s discretion, not to be unreasonably withheld, to release an appropriate level of additional funds prior to the annual reconciliation. Conversely, if actual costs were consistently and considerably lower, the Authority could suggest a mid-year interim reconciliation.

7.4. The example below shows how payments will be made, with reconciliation occurring at the end of the year.

*Payment profile*

7.5. Although usually reconciliation will only occur annually, suppliers will be required to submit each month the actual costs for the previous month, both to ensure that the Authority was sighted on year-to-date costs, and to allow open-book checks to be spread out throughout the year.

7.6. Suppliers will export their actual cost data into an Authority-provided template (based on the bid financial response template, with clear guidance about which costs should be recorded where) each month. This template will flag any differences from the expected costs in each category and at aggregate levels. This will allow the Authority to identify any areas of costs for further investigation or discussion with the supplier, based on those which were highest risk either inherently (e.g. corporate overheads, intergroup transfers) or in terms of actual departures from expected and accepted costs from bid stage.

7.7. Suppliers will be required to self-certify the accuracy of their cost data, but in addition, supporting information such as workforce data, payroll or copies of invoices will be provided by the supplier, either routinely or upon request by the Authority. The same information could be requested for the costs and income (related to this contract) of any key suppliers (exact definition tbc, but organisations under the same ultimate control which account jointly for at least 5% of costs, and any intra-group transfers between parts of the same organisation that ultimately owns the contractor).

7.8. On a monthly basis the Authority will carry out post-payment validation checks on transactional information supplied, on a sample basis. Any errors identified in cost classification or value that will affect the amount payable will be extrapolated, and discussion held with the supplier to confirm the values to be deducted from future payments. We will include further details on how
extrapolation of any identified errors will work in the draft contract schedules. We will reserve the right to carry out further adjustments at a later stage if further information is identified which would have affected earlier reconciliations.

7.9. The Authority will have the right to agree with the supplier its annual audit scope, with a counter signatory from the MOJ (Deputy Director level). We may set some general guidelines for audit scopes to include. The aim of this exercise will be to seek third party assurance around the relevant profit figures, once the eligible deductions have been made. This offers the Authority some protection in ensuring the correct levels of profit are being made, and pain/gain share is being applied correctly. Furthermore, it will ensure that dividends being paid by the supplier are only done so once the contractual financial covenants are met. Any costs relating to the annual audit will be borne by the supplier.

8. **Profit on Unpaid Work**

8.1. The Community Payback (Unpaid Work) Manual contains various requirements regarding the receipt of income from beneficiaries of unpaid work, including the following:

8.1.1. “Providers of Community Payback are able to reduce their costs by working in partnership with organisations which use unpaid work to benefit local communities. Cost reductions may be achieved in a number of ways, including:

8.1.1.1. benefit in kind arrangements in which partner organisations undertake some direct supervision of suitable offenders, under the overall management of the Community Payback provider;

8.1.1.2. donations or financial contributions by the organisations benefiting from the work, for example donations of materials and equipment or monetary contributions towards the cost of offender supervision and other costs.”

8.1.2. “If a beneficiary organisation agrees to make a financial contribution towards the cost of delivering Community Payback, it should be clear that this is a contribution towards the cost of offender supervision and other expenses incurred by the provider and not a payment for offender labour.”

8.1.3. “Providers of Community Payback should not engage with commercial organisations where there is a risk that offender’s work on Community Payback will contribute to private profit. It may however be appropriate to place offenders with private sector organisations if the work undertaken provides benefit to the community and has a clear social purpose.”

8.2. Further information is available in the Community Payback Manual. However, for the purposes of the payment mechanism, it will be important that any beneficiary income is recorded in the monthly submissions so that there is no risk of double payment for any costs related to unpaid work. This income will be offset against the costs of delivering the service when assessing actual costs and available profit levels.

8.3. Benefits in kind, such as provision of materials or equipment used in unpaid work, will not need to be recorded as actual costs or income.
9. Awarding of profit / surplus

9.1. Although the availability of profit / surplus will be dependent on where actual costs were in relation to target costs, the actual awarding of profit will be dependent not only on whether costs were below the maximum price, but on whether the performance measures were achieved.

9.2. There will be 2 types of payment adjustments:

9.2.1. Profit reductions, which reduce the available profit by a proportion related directly to the level of underperformance (capped at 100% of all available profit) and the weighting of the measure; the weighting can also be increased, up to twofold, by a ratchet mechanism if there is continued underperformance beyond two reporting periods;

9.2.2. Beyond-profit deductions, which are a percentage of target profit and would only apply after four periods of sustained underperformance

9.3. Profit reductions: The key performance measures have each been weighted, to represent a given percentage of the available profit.

9.4. For the quantitative service levels, there is a 10% range below the performance target whereby each percentage point reduction in performance corresponds to a 10% reduction in profit for that weighted portion of profit.

<table>
<thead>
<tr>
<th>Ref</th>
<th>Measure</th>
<th>Target</th>
<th>Zero profit threshold</th>
<th>Weight</th>
</tr>
</thead>
<tbody>
<tr>
<td>SL1</td>
<td>Starts UPW within 10 BDs</td>
<td>90%</td>
<td>80%</td>
<td>10%</td>
</tr>
<tr>
<td>SL2</td>
<td>Completes UPW within 12 months</td>
<td>90%</td>
<td>80%</td>
<td>16%</td>
</tr>
<tr>
<td>QM1</td>
<td>UPW Delivery</td>
<td>G</td>
<td>R</td>
<td>16%</td>
</tr>
<tr>
<td>QM2</td>
<td>Quality of ETE provision in UPW delivery</td>
<td>G</td>
<td>R</td>
<td>8%</td>
</tr>
<tr>
<td>SL3</td>
<td>Waiting time for Accredited Programmes starts from programme ready referral of eligible service users</td>
<td>TBD</td>
<td>TBD</td>
<td>10%</td>
</tr>
<tr>
<td>SL4</td>
<td>Accredited Programme completion by eligible service users</td>
<td>90%</td>
<td>80%</td>
<td>15%</td>
</tr>
<tr>
<td>QM3</td>
<td>Accredited Programmes Delivery</td>
<td>G</td>
<td>R</td>
<td>10%</td>
</tr>
<tr>
<td>QM4</td>
<td>Liaison with RO</td>
<td>G</td>
<td>R</td>
<td>10%</td>
</tr>
<tr>
<td>SL5</td>
<td>Accurate Financial Reporting</td>
<td>95%</td>
<td>80%</td>
<td>5%</td>
</tr>
<tr>
<td>TOTAL</td>
<td></td>
<td></td>
<td></td>
<td>100%</td>
</tr>
</tbody>
</table>

9.1. Quality ratings correspond to the proportion of cases meeting an acceptable standard, the top rating (Green) meaning that 87% or more cases meet that standard, and 100% of the available profit can be awarded. At the other end of the scale, Red means that fewer than 60% of cases meet an acceptable standard, and no profit will be awarded for that measure.

9.2. Between the Amber rating (60%) and the Green rating (87%), profit will be awarded according to the score achieved, with more profit being received for each % point improvement. A score within the A/G range will attract twice as much profit as a score within Amber. This reflects the fact that A/G is the desired level of quality, and the Authority’s wish to reward higher A/G scores as well as reaching a Green rating. The following table shows the profit awarded for each % point
improvement within Amber and A/G and the range of available profit awarded for each rating.
For quality measures, deductions will be gradual for each percentage point below green, as shown below:

<table>
<thead>
<tr>
<th>Thresholds</th>
<th>Profit* awarded per % point</th>
<th>Range of Profit awarded</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rating (% cases meet acceptable standard)</td>
<td>Measure attached to 10% available profit</td>
<td>Measure attached to 16% available profit</td>
</tr>
<tr>
<td>R (up to 59%)</td>
<td>--</td>
<td></td>
</tr>
<tr>
<td>Amber (60% - 72%)</td>
<td>0.23%</td>
<td>0.37%</td>
</tr>
<tr>
<td>A/G (73% - 86%)</td>
<td>0.47%</td>
<td>0.74%</td>
</tr>
<tr>
<td>Green (87%+)</td>
<td>--</td>
<td>10%</td>
</tr>
</tbody>
</table>

9.3. To address ongoing underperformance, both in general and specifically in a high cost and therefore low or no profit scenario (but see also section 10 on a price adjustment mechanism which could put a supplier back into a place of profit being available for deductions, if appropriate), there will be both ratcheting of profit reductions and beyond-profit deductions.

9.4. **Ratchet mechanism**: The ratchet mechanism provides an incentive for suppliers to focus on performance across the board and not to neglect a single measure. If a measure is neglected the ratchet will increase the weighting therefore further impacting profit.

9.5. The underperformance count increases by 1 for every measurement period (i.e. quarters for service levels or six months for quality measures) that performance is under the “Underperformance Threshold”, i.e. the target for service levels. If there are 2 consecutive periods of performance above the threshold, then the count is reset to 1.

9.6. After the third period of underperformance a ratchet mechanism applies and increases the weighting by 20%. This continues, increasing the weighting by 20% each period until the weighting is doubled. The ratchet is cancelled/reset to 1 by two consecutive quarters above the underperformance threshold.

9.7. For example, if performance had been continuously at 94% for 3 quarters (after the Service Level Holiday), the ratchet would have increased weighting by 20% and the reduction would then become 0.5% x 1.2 = 0.6%.

9.8. The sum of reductions from all measures is capped at 100% of the total Available Profit. Therefore, although a single measure can double in weight, this would effectively come out of the available profit from other measures that are performing well.

9.9. Quality Measures work in the same way to Service Levels in terms of the ratchet and the deductions. However, the initial calculation of the reduction percentage is slightly different.

9.10. 100% of the profit available for each measure is awarded at the target (87%). Zero profit is awarded performance at 59%. For performance between 73% to 86% (amber/green rating), twice as much profit is awarded for each percentage point as for performance between 60% and 72%.
(amber rating). The purpose is to incentivise improvement into and through Amber/Green. This means each % point below target equates to a reduction of 4.651% between 73% and 86%, and a reduction of 2.325% for each percentage point in the range 60% to 72%.

9.11. For a 16% weighted quality measure:

4.651% x 16% = 0.74% (amber/green)
2.325% x 16% = 0.37% (amber)

For a 12% weighted quality measure:

4.651% x 12% = 0.56% (amber/green)
2.325% x 12% = 0.28% (amber)

9.12. Beyond-profit deductions: Deductions provide a financial lever which goes beyond profit where underperformance is being sustained. This gives a bigger incentive to improve performance, particularly at high operating costs: i.e. if a supplier is operating close to GMP, there is very little available profit so financial levers are small, and without deductions there would be little financial incentive to improve performance unless costs can be reduced or the price adjusted. However, It will not be possible for suppliers to reduce costs in order to cover the deductions, thus risking the service, because the deduction will be made from whatever the level of costs is, so it will need to be funded through other means than cost-cutting measures.

9.13. Deductions will be calculated using the target profit amount which would be available if the actual cost was equal to the target cost, but they will only be applied on any measure where there had been under-performance for four quarters of poor performance. The four quarters don’t need to be consecutive, but two consecutive quarters of sufficient performance will re-set this so the count of four would re-start.

9.14. If performance was at 94% on a service level with a target of 95% and a weighting of 5%, 0.5% (i.e. 10% of 5%) of target profit would be deducted from the final payment (as well as reducing the available profit). If the supplier had no available profit because they were operating at or near GMP (depending how high their target profit was) then this could put them into loss-making territory.

9.15. Deductions will apply in addition to any applicable reductions, so a given measure could have both a reduction and a deduction simultaneously, if there was profit available.

9.16. Although performance will be assessed quarterly, deductions from profit will only be made annually, with the annual profit being divided by four to give a quarterly profit, and each quarter’s performance being applied to the average quarterly profit amount.
9.17. There would be a ‘grace’ period at the start of the contract, free from adjustments, where suppliers receive all the available profit. This would be different for service levels and quality measures, as shown in the timeline below. The grace period for SLs would be two quarters – additionally targets would ramp up gradually during the first contract year. For quality measures, there would be no profit reduction in contract year one, and only partial profit reductions in contract year two. This in effect provides a ‘glide path’ to full implementation at the start of contract year three.

9.18. **Transition and mobilisation**: The profit due for the mobilisation and transition element will be payable subject to relevant milestones being met. Further details to be provided on what the milestones will be.

### 10. Price adjustment mechanism, allowable assumptions and true-up

10.1. To address the fact that target costs might have been set incorrectly to a greater extent than manageable under the target cost model, with suppliers consistently too close to the GMP or profit cap, we will include a price review mechanism in the contract.

10.2. If for two consecutive years the profit is between 15% and the profit cap threshold (i.e. 20%), the Authority may, at its discretion, carry out a price review.

10.3. If for two consecutive years the actual cost is 15% or more than the target cost (*assuming GMP is 20% above TC*), the supplier may request a price review and the Authority will, at its discretion, consider any information the supplier puts in favour of a review, in line with the following requirements.

10.4. The contract will set the terms of the review (based on similar mechanisms in other contracts), having regard to factors such as the caseload mix, resource model and salary costs set at bid stage, external factors and benchmarking of other suppliers and/or other similar services. For a price increase, the onus will be on the supplier to demonstrate that there were factors outside of their control which had caused costs to be higher than could reasonably have been anticipated at bid-stage. The exact terms are subject to further consideration to take into account relevant case law.

10.5. Having this mechanism will allow a correction if bids were set incorrectly resulting in under or over-funding the service and, at higher costs, the reduction in effectiveness of the profit deduction mechanism for under-performance. However, it could be very time and resource-consuming to conduct a review, and frequently benchmarking exercises outside of the competitive pressure of a bidding process do not result in good value for money. Moreover, it will have the risk that it could encourage bidders to under-bid to begin with, or it could reward inefficiency, so it must therefore be carefully limited.
10.6. There will also be allowable assumptions agreed which could cause the price to be adjusted (in pre-defined ways) if the assumptions turned out not to be correct. Bidders can propose these at bid stage, but if the Authority accepts them and they are relevant to all contracts, we will look to apply them equally to all contracts.

10.7. We are also considering whether to apply some sort of true-up mechanism to all contracts in the following areas:

10.7.1. Rental costs of properties that transfer to suppliers will be correct as per the data room;
10.7.2. The asset register is correct (within a de minimis amount);
10.7.3. The number of transferred staff at contract start, where this has changed since the data room;
10.7.4. Pension contribution rates will remain as per the contract; any changes will be reflected in a price adjustment.

11. Indexation

11.1. Indexation will be applied annually on the following basis:

11.1.1. staff costs and non-staff costs should be split and indexation applied separately to each;
11.1.2. non-staff costs should be indexed by Consumer Price Index (CPI);
11.1.3. staff costs should be indexed by Average Weekly Earnings (AWE), but staff cost indexation should only be applied to contracts at the level they are able to evidence has been passed to staff;
11.1.4. further detail to be provided on what point in contract year it will be calculated in advance of following year.

11.2. Non-staff costs formula:

Value of Non-Staff Costs in Contract Year x (CPIb / CPI a)-1

Where:

CPIb = the Consumer Price Index Value for a designated month b (e.g. September 2020)
CPI a = the Consumer Price Index Value for a designated month a, which falls 12 months before b (e.g. September 2019)

11.3. Staff costs formula:

Value of Staff Costs in Contract Year x ((AWEb / AWEa)-1)

Where:

AWEb = the level of Average Weekly Earnings during a designated month b (e.g. September 2020) as stated under the whole economy AWE excluding bonuses measure; and
AWEa = the level of Average Weekly Earnings during month a, which falls 12 months before b (e.g. September 2019) as stated under the whole economy AWE excluding bonuses measure.
11.4. All index values shall be as identified on the Office of National Statistics Website: [https://www.ons.gov.uk](https://www.ons.gov.uk).

11.5. Staff Cost indexation would represent only the maximum which if passed onto staff will be reimbursed by the Authority through the Payment Mechanism. If a lower value is passed onto staff, the Authority will only reimburse up to the value which is evidenced.

11.6. All indexation shall be based on “no rounding” of the percentage change of the relevant price index, although the payment itself shall be rounded to the nearest 1 pence.

11.7. The relevant price index will remain as quoted by the Office of National Statistics at the point of Authority assessment, any retrospective changes in the relevant price index shall not result in a re-assessment of the indexation for the Contract.

11.8. Indexation will be applied in the same way to any new or changed requirements and pricing.

12. Unallowable costs

12.1. As part of the approach to open book accounting, the contract will state a general principle that costs be necessary, reasonable and proportionate for the purpose of fulfilling the contract. It will also provide an indicative, non-exhaustive list of rules on costs, for instance:

12.1.1. Bad debts;
12.1.2. Financing costs / interest;
12.1.3. Depreciation;
12.1.4. Litigation / legal costs for claims against the Supplier or the Authority, including but not limited to employee tribunal cases;
12.1.5. Third-party liabilities;
12.1.6. Staff travel and subsistence will only be reimbursed in line with MoJ travel policy (NB we are looking at what else should be on the unallowable list);
12.1.7. Corporate overheads will not be accepted at a higher level than the level set in the bid.

12.2. We do not expect there to be any pass-through costs.

13. Questions to be discussed at market engagement

We would welcome your views on the following aspects of the paymech:
• Our responses and updates (covered throughout the paymech description)
• Any further thoughts on groups and individuals for accredited programme volume unit?
• Allowable assumptions
• Indexation
• Profit reductions and ratchet mechanism (if not already covered in performance session)
• Beyond-profit deductions

We would welcome your views on the following aspects of the financial response template:
• Are the inputs correct? Do they match how you would estimate costs?
• Does the resourcing formula work? Would you expect it to change over time due to expected efficiency savings, and if so how often?
• Is other income captured correctly?
• How should we capture pension costs, given that different people will be on different schemes, and the proportion is likely to change over time? On what basis would you estimate this?
• Would you also expect a variety of salary costs by grade, or can this be subsumed within averages? Would the average change over time?
• Do differences between urbanity and rurality or individual and group UPW placements need to be captured, or can this be subsumed as averages?
• Do capital and resourcing expenditure need to be separated?
• Should we separate the inputs into different tabs?