MANAGING CONTRACT RISKS IN OUTSOURCING AGREEMENTS

By Kenneth Hayslette

Managing risks in regular governmental contracts is a challenge. Identifying the contract risks, trying to develop a practical plan to prevent or preclude them from occurring, and then trying to mitigate the impact if an identified risk occurs are significant challenges in "regular" contracts. Outsourcing contracts have all of the "regular" risks associated with any contract – technical, financial, schedule, and hazards – but each also has its own special set of risks. An outsourcing agreement is a situation in which the government decides to contract with an outside provider to perform services that had previously been provided by government employees.

Of course, the risk of performance failure is very significant in an outsourcing agreement. If the contractor does not perform the services for the government's citizens, clients and/or constituents, then the government has failed in its duties. Sometimes failure in performance can be life-threatening. Think about the impact of performance failure in ambulance services, fire services, or other health and safety services. If these services are not performed properly and in a timely manner, people can die. Other services, such as managing the issuance of automotive tags or other "administrative" government, are not life-threatening; however, the impact of nonperformance on the taxpayers and constituents can be severe. If an outsourcing contractor embezzles only a few thousand dollars, what is the impact of that lost money to the fiscal health of the government? Look at what has happened to some of the governments around the nation and their financial situations.

> Because the outsourcing contractor is a representative of the government, any breach or apparent breach of ethical standards will be magnified and reflected back on the government.

Another special risk issue in outsourcing contracts is ethical standards, which all government contractors have a duty to maintain. Because the outsourcing contractor is a representative of the government, any breach or apparent breach of ethical standards will be magnified and reflected back on the government. The question is: How do we, as public procurement professionals, analyze and develop a risk management plan to preclude any ethical, moral or integrity breaches? Can we write ethical standards into the contract document? Even if these standards are in the contract document, how do we monitor and enforce them? And, if there is an ethical breach in the performance of the contract, what can we do to mitigate its impact on future performance of the contract and upon the reputation of the government?

As a part of the performance risk, the contractor's fiscal health is more important in an outsourcing agreement than in a regular contract. In a regular contract we usually have the opportunity to go to another contractor to buy replacement performance. In an outsourcing agreement, while that option may be still available, it is much more difficult and expensive to buy replacement performance when all of our proverbial eggs are in the contractor's basket.

The importance of the contract administration/monitoring function in an outsourcing agreement is even more significant than in a regular service contract. Unfortunately, many governments have outsourced performance of governmental work to private contractors and have not maintained adequate staff to administer the contract once it's been awarded. Some government leaders think that outsourcing is a tool to reduce the number of government employees. This is true; however, the government must maintain adequate contract administration staff with the needed knowledge, skills, and resources to properly monitor and manage the contract, and especially to address the key risks that have been identified in the outsourcing risk management plan. Otherwise, the opportunity for contract failure is greatly increased and therefore the citizens will be dis-serviced.

There's no simple answer or a single matrix to plug in information and come up with the ideal risk management plan. Every outsourcing agreement is unique. However, there is a magic formula that you can use to assist you in managing the risks in an outsourcing contract. Before you start crafting your RFP, follow the following steps.

> **Consider that Murphy was an optimist!**

> **Think about everything that could go wrong in the ensuing contract.** Write them all down.

> **Identify and rank the top 25 potential failures from your list that would impact the success of the contract -- and the success of the government in performing its services for its citizens.**

> **Think about and write out the risk factors for each of the first 25 potential failures.**

> **For each risk factor identified, answer the following:**

> **What is the key causative agent for the risk factor?**

> **What would trigger the risk factor?**

> **How can we prevent it?**

> **How can we mitigate the impacts if it occurs?**

> **How can we ensure that if something goes wrong that it has the least amount of impact on the government and its citizens and constituents?**

Now take these ideas and develop your risk management plan. Include all of the items from your plan in the performance requirements of the Statement / Scope of Work for your Request for Proposals (RFP). As part of the RFP, ask the potential proposers to provide their analysis of the potential contract risks and how would they go about precluding the risk, or mitigating the impacts if the risk factor becomes reality.

The last and most difficult part – proactively manage the risks!

If outsourcing contracts were easy, then there would be no need for procurement professionals. Contractual risk management is a challenging concept, but the challenges can be overcome so that all parties are successful regardless of what occurs. ■

EDITOR'S NOTE: The author, **KENNETH HAYSLETTE**, CPPO, C.P.M., CPCM, Alexandria, Va., will be conducting the workshop "Contractual Risk Management in Outsourcing Agreements" at NIGP Forum on Wednesday, Aug. 22, from 1:30 to 2:30 p.m.