**FINANCIAL AND BUSINESS MANAGEMENT TRAINING FOR ROAD CONTRACTORS**

**MODULE SIX SESSION FOUR**

**CONTRACT.**

**1.0 Training Objectives**

This session introduces trainees to contracting in road works. Specifically trainees will learn to:

1. Explain the meaning of a contract
2. Outline and explain the elements of a contract
3. Explain the various contract types, their advantages and disadvantages
4. Discuss the factors considered in selecting a contract type.

By the end of the module, participants will:

1. Appreciate the concept of contracts as it relates to the road sector
2. List and discuss the key elements of a contract
3. List the different types of contracts in the road sector
4. Explain the importance of having a signed contract

**1.6 CONTRACTING IN ROAD WORKS**

To start with, a road contractor should be familiar with the following:

1. What is a Contract?
2. What constitutes a contract?
3. Terminologies used in contract management
   1. **Definition of a Contract**

A contract means an agreement between two parties: a procuring entity and a provider, resulting from the application of the appropriate and approved procurement procedures, concluded in pursuance of a bid award decision of a Contracts Committee or any other appropriate authority.

* 1. **Contract Documents**

A contract under the PPDA act is made up of different documents produced in the course of the procurement process. The documents forming the Contract are interpreted in the following order of priority;

a) Agreement (contract form),

(b) Letter of Bid Acceptance,

(c) The Provider’s Bid, as amended by any clarifications or negotiations,

(d) Special Conditions of Contract,

(e) General Conditions of Contract,

(f) Statement of Requirements,

(g) Any other document listed in the SCC as forming part of the Contract.

* 1. **What constitutes a contract?**

Essential elements in a contract are:

* Agreement between parties (an offer and acceptance)
* Intention to enter into a legally binding agreement
* Consensus about the subject matter
* Provision of a consideration.
* Parties must have capacity to contract.

Contracts only arise when the parties have an intention to enter into a legally binding relationship. One party makes an offer and another accepts the offer. The parties must have a meeting of minds about the subject of the contract and each party must provide a consideration. The consideration must have value but need not be adequate. Minors, the insane and ones declared bankrupt cannot enter into a valid contract.

* 1. **Types of Contracts**
* Lump sum contract
* Time based contracts
* Ad measurement
* Framework Contracts
* Percentage Contracts
* Petty Contracts
* Cost Reimbursable contracts.
* Target price Contracts
* Retainer Contracts.
* Contingency or Success fee.
  1. **Lump Sum Contracts:**
* Content, duration and outputs are defined.
* Based on agreed price and payments for the whole contract
* Specified outputs may include:
  + Payment schedule
  + Bills of quantities/statement of deliverables
  + Drawings
  + Deliveries of supplies
  + Activity schedules
  + Reports etc

The risk of cost variations are born by the provider.

* 1. **Time based Contracts:**
* Used when the scope and duration of the task are difficult to define.
* Payment is based on agreed hourly, weekly or monthly fees.
* Carters for reimbursable.
* Supervisor monitors progress of contract and payments (contract terms).

**Benefits and Challenges**

**Benefits:** It is ideal where scope is unknown, while cost control and value for money are easy to achieve given good supervision.

**Challenges:** Difficult where record keeping is poor and both parties need to be open and to closely monitor and supervise the operations..

* 1. **Ad measurement Contract:**
* Are based on Unit rate and measured quantities. Works done are measured and valued at the agreed rate.
* Mainly used for works contracts that are not well defined where unforeseen site conditions may exist such as hidden foundation problems.
* Total price is determined basing on quantity and unit price.

**Benefits:**

* Good for long term contracts where quantity estimates may be inaccurate.(estimation) but out put can easily be ascertained..
* Best for works contracts (Bills of quantities)

**Challenges:**

* Costs are uncontrollable (risky)
* Risk of quantity variations are born by the PDE.
  1. **Framework Contracts**

Framework contracts are not task specific. The contract remains valid for a period of time and any works necessary during that period are done as part of the framework contract. It is suitable for recurring tasks such as road maintenance.

* Requirements can be given by “call off basis” and quantity and timing not known.
* Reduces procurement costs and lead times
* Unit rate is made known by provider and entity estimates the quantity.
* Payments linked to delivery/performance.
  1. **Percentage based Contract**
* Appropriate to relate the fee paid directly to estimated/actual cost.
* Contract must define total cost of contract from which the percentage is to be calculated
* Bidder is paid on agreed percentages.

An example is say “a professional fee of 5% of cost of works”. Under such a contract the total cost of works will be ascertained then the professional fee computed as a percentage of the cost.

* 1. **Cost reimbursable Contracts**

Such contracts are suitable for:

* Emergency works contracts where cost is difficult to calculate or there is no time for such to be ascertained.
* High risk works where it is not economical to bear the risk of variations,
* Where the provider is not willing to accept the risk.
* Where payment linked to actual works with evidence of receipts, invoices and other relevant documents.
* Profit element agreed in the contract.

**Benefits and Challenges**

**Benefits**:

* Early commencement is possible
* Change control easy
* Client has a strong influence

**Challenges:**

Under such arrangement the costs are unknown and can spiral. The method does not give any incentive to the provider to save or tp be efficient. Therefore it can only be meaningful where the contractor is good, technically competent and ethical.

* 1. **Target Price Contract**
* Target price is known and incentives offered for any savings below the target.
* Payment are based on receipts and appropriate documentation:

**Benefits:**

* Costs easily controlled
* Lead-times are reduced as contract price is agreed.

The main challenge with this type of contract is that savings may lead to substandard work.

* 1. **Retainer Contract**
* Used to retain a provider to offer services over prescribed period of time.
* Level and amount of service is not defined.
* Payment is mainly on flat fee.
* Retainer for prescribed period plus pre-agreed unit rate for a service.

**Benefits**

* Used to retain a provider to offer services over prescribed period of time.
* Level and amount of service is not defined.
* Payments is mainly on flat fee.
* Retainer for prescribed period plus pre-agreed unit rate for a service.

The challenge with this contract is that it may be difficult to terminate a provider who has performed in the initial stages

* 1. **Contingency or Success fee**
* Links a provider’s fee to an achieved objective to provide an incentive to the successful completion of a task.
* Payment may be pre-agreed, percentage of agreed amount or basic flat rate and linked to successful completion.
* Contract describes nature of success, time scales and action to be achieved

While this type of contract may motivate a vendor towards better service delivery; it pauses a challenge as the pre agreed amount may be based on a wrong assumption and thus prove difficult for provider to implement

* 1. **Petty Contracts**

This deals with minor contract for works and services.

* Carried out mainly by casual workers (Digging trenches, road works, drain cleaning, ferrying etc.)
* Supply of goods or materials requires a local purchase order.
* Authorization from head of department and maintain a register of petty contracts.
* Payments supported by petty contract voucher.
  1. **Other Contracting Arrangements**
* Build own operate (BOO)
* Build own transfer (BOT)
* Build own operate transfer (BOOT)
* Public Private Partnerships (PPP)

**1.23 Factors considered in selecting contract type**

* Nature of Procurement
* Minimisation of risk
* Value for money
* Cost control
* Organizational requirements