

Serving the Community By Using the Private Sector

A User Guide to Contract Management

February 2007



EFFICIENCY UNIT VISION AND MISSION

Vision Statement

To be the preferred consulting partner for all government bureaux and departments and to advance the delivery of world-class public services to the people of Hong Kong.

Mission Statement

To provide strategic and implementable solutions to all our clients as they seek to deliver people-based government services. We do this by combining our extensive understanding of policies, our specialised knowledge and our broad contacts and linkages throughout the Government and the private sector. In doing this, we join our clients in contributing to the advancement of the community while also providing a fulfilling career for all members of our team.

Other Efficiency Unit Documents

The Efficiency Unit has produced a number of detailed guides including on outsourcing and Public Private Partnerships (PPPs). These may be found on the Efficiency Unit website at www.eu.gov.hk.

Throughout this document the term department is used to describe all government agencies.

INTRODUCTION

The Hong Kong civil service has embraced the outsourcing of many services to the private sector over the past years. There has been a very long tradition of the Government's capital works programme being outsourced. The role of our works departments has been to plan and design, to secure funding, to procure contractors in a fair and transparent manner, to manage contracts, to ensure public safety and health, and to be accountable to the community. They have done this job admirably over the years.

For the non-works departments there is a different story. Until recently, most departments provided most of their services in-house using civil servants. The transfer of many of these service delivery tasks to the private sector has transformed and upgraded the role of many civil servants to contract managers. This requires a new and different set of skills.

On the one hand contract managers need to ensure that they continue to obtain value for money and good service quality from the outsourcing contractor. In addition they must take vicarious responsibility for the non-skilled workers engaged by contractors. This has been a steep learning curve for all of us.

Over the past year or so the Efficiency Unit has helped identify common areas where individuals and departments lack the experience, knowledge, skills or confidence to perform at the high standards that the Hong Kong civil service sets itself. We know that we cannot produce experience overnight. But we can pull together much of the knowledge, skills and best practices that will give colleagues the confidence to make the goal of excellence so much easier to achieve.

This User Guide is a first attempt in Hong Kong to provide handy, accurate, practical and relevant guidance to civil servant contract managers and frontline supervisors. We are grateful to departments for contributing so generously by sharing their experiences and knowledge with us. The Efficiency Unit would also warmly welcome any feedback on this User Guide so that we can both share with other departments as well as improve future editions.

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1 PURPOSE OF THE USER GUIDE

1.1 Background

It is the policy of the Hong Kong Special Administrative Region Government that departments should, where possible, use the private sector to assist the Government in delivering public services. This strategic direction is in line with the Government's economic and fiscal objectives of maintaining a small and efficient government, containing the size of the civil service and promoting business opportunities and jobs in the private sector. Consequently, the Government has been outsourcing various services to contractors for many years and will continue to do so in the future.

The Efficiency Unit (EU) has recently reviewed the outsourcing practices undertaken by a number of departments (the 2005-2006 Outsourcing Review). The results of the review revealed a number of concerns and challenges in planning and managing the outsourcing of non-works services. The EU, therefore, commissioned the preparation of this User Guide, which is a systematic set of guidelines to facilitate departments in preparing, managing and monitoring outsourcing contracts.

1.2 Scope of the User Guide

Outsourcing usually gives rise to an agency relationship or one where the service provider is acting for or operating on behalf of the Government in its dealings with third parties, usually the public. This is so even though the contracts between government and the service providers are expressed on a principal-to-principal basis.

The public looks to government to deliver the service (albeit by means of the service provider) and government's recourse is against the defaulting service provider. Care, therefore, needs to be exercised in tendering, negotiating and monitoring the service provider.

The procurement of consultancy services is governed by different procedures and should not be confused with other service contracts.

1.3 Purpose of the User Guide

The purpose of the User Guide is to:

- ◆ Provide guidance on how to address commonly encountered challenges in contract preparation, management and monitoring;
- ◆ Share both local and overseas outsourcing experience and lessons learnt.

The target audience of the User Guide includes any personnel who are involved in planning, managing and supporting the outsourcing projects in government departments. In particular, this includes:

- ◆ Contract managers of non-works service contracts - providing them with the knowledge and skills required to prepare and manage high quality service contracts;
- ◆ Frontline supervisors of non-works service contracts - providing them with practical advice and guidance on monitoring the performance of contractors cost-effectively and efficiently;

- ◆ Departmental trainers - supplying them with basic information and examples for outsourcing courses to be given to contract managers and frontline supervisors, enhancing their concepts and facilitating their understanding of outsourcing.

This User Guide focuses primarily on outsourcing non-works services, but some of the advice provided here is also applicable to works/construction and consultancy contracts. Those involved in Public Private Partnerships (PPP) projects may also find this document useful.

The User Guide supplements the document “Serving the Community – By Using the Private Sector – A General Guide to Outsourcing” (Outsourcing Guide) published by the EU. Whilst the Outsourcing Guide focuses on the “processes” for approaching outsourcing, the User Guide attempts to address the “content” challenges that will likely be encountered during different stages of the outsourcing process. The User Guide is intended only to act as a set of guidelines. It should not be treated as representing the one and only way forward. Users of the guide should always exercise professional judgement when adopting the guidelines for their outsourcing projects. In particular, departments should exercise judgement and common sense, taking into account the size, value, complexity and length of a contract when considering what measures to apply and adopt.

1.4 Structure of the User Guide

The User Guide is organised into the following chapters:

- ◆ when developing the business case, refer to:
 - Chapter 2 - Regulatory Framework for Outsourcing Contracts
 - Chapter 3 - Balancing Competition and Compliance with the WTO GPA
 - Chapter 4 - Properly Allocating Roles Within a Department
 - Chapter 5 - Different Business Models and External Outsourcing Expertise
 - Chapter 6 - Defining Attractive Commercial Arrangements
- ◆ during tendering and selection, refer to:
 - Chapter 7 - Developing High Quality Tender Documentation
 - Chapter 8 - Formulating Marking Schemes that Emphasise Quality of Service
 - Chapter 9 - Effective Performance Management
- ◆ for contract management, refer to:
 - Chapter 10 - Managing Contractor Relationships
 - Chapter 11 - Encouraging Good Practices from Contractors
 - Chapter 12 - Contractor Malpractices
 - Chapter 13 - Dispute Resolution
 - Chapter 14 - Approaching the Expiry of Contracts.

2 REGULATORY FRAMEWORK FOR OUTSOURCING CONTRACTS

Outsourcing is governed by a regulatory framework, which is comprised of the following sources:

- ◆ the World Trade Organisation Agreement on Government Procurement (WTO GPA);
- ◆ the Stores and Procurement Regulations (SPR);
- ◆ various financial circulars issued by the Financial Services and Treasury Bureau (FSTB);
- ◆ various laws and regulations administered by departments such as the Labour Department.

Figure 1 highlights the list of related circulars and sources of advice, which is accurate as of the publication date of the User Guide. Departments should check the detailed requirements, identify whether there are any updates and seek advice from relevant departments where necessary.

Figure 1 – List of key outsourcing-related government circulars and sources of advice

Name	Title	Date	Brief description
1. Document from International Law Division of the Department of Justice (DoJ)	Q and As on WTO GPA	April 2006	Concise answers to frequently asked questions on the coverage and provisions of the WTO GPA
2. FC10/97	WTO Agreement on Government Procurement	20 May 1997	Changes in tendering practices and procedures following Hong Kong's accession to the WTO GPA Note that the WTO GPA does not apply to all procurement (refer to Chapter 3 for details)
3. FC11/97	Access to Tender Information	15 July 1997	Sets out the types of tender information that may be disclosed and guidelines for handling tender information requests
4. FC14/97	Stores and Procurement Regulations	2 December 1997	Regulates matters relating to the management and procurement of government stores and services
5. Ref(107) in FT 53/88 Pt. 2	Selection of Combination of Tender	8 February 2002	Secretary for the Treasury's memo on the selection of combination of tenders

REGULATORY FRAMEWORK FOR OUTSOURCING CONTRACTS

Name	Title	Date	Brief description
6. FT 53/88 Pt 3	Restriction on the Maximum Number of Contracts to be Undertaken by the Same Contractor	18 November 2004	Secretary for the Treasury's Memo on the imposition of a restriction on the maximum number of a particular type of contract that a contractor can undertake simultaneously
7. FC3/2004	Mandatory Requirements for Tender Assessment and Demerit Point System (DPS) for Contractors of Service Contracts	27 March 2004	<p>Applies to tenders for service contracts (excluding construction service contracts) that rely heavily on the deployment of non-skilled workers, invited on or after 27 March 2004 and before 1 May 2006</p> <p>Considers past records of convictions under specified Ordinances and non-compliance with specified contractual obligations in the evaluation of tenders for relevant service contracts. Tender offers from contractors who are found to have three convictions under the specified Ordinances or six demerit points issued for breaches of specified contractual obligations shall not be considered</p>
8. FC5/2004	Mandatory Requirement for Service Contracts	6 May 2004	<p>Applies to tenders for service contracts (excluding construction service contracts) that rely heavily on the deployment of non-skilled workers invited on or after 6 May 2004</p> <p>Wage offers by tenderers which are less than the average wage for the relevant occupations as published in the Census and Statistics Department's Quarterly Report of Wage and Payroll Statistics shall not be considered</p>
9. FSTB Circular Memo 4/2004	Mandatory Requirement for Service Contracts - Contract Variation	17 May 2004	For service contracts covered by FC5/2004, contract variations are in many cases temporary expedients for procurement of service which should normally be procured through tender procedures or under direct purchase authority. Controlling Officers should observe the new mandatory requirement in case of contract variations where the contract variation entails an extension of the contract period or the deployment of additional non-skilled workers
10. Memo from FSTB re Standard Employment Contract	Memo on Standard Employment Contract from FSTB	29 April 2005	<p>Applies to tenders for service contracts (excluding construction service contracts) that rely heavily on the deployment of non-skilled workers</p> <p>Stipulates the use of a Standard Employment Contract setting out the employment terms and conditions as a mandatory contractual requirement</p>

REGULATORY FRAMEWORK FOR OUTSOURCING CONTRACTS

Name	Title	Date	Brief description
11. Memo from FSTB	Services Contracts Covered by Financial Circular No. 5/2004 – Tenders to be deemed in compliance with Mandatory Wage Requirement	18 May 2005	<p>Applies to tenders for service contracts (excluding construction service contracts) that rely heavily on the deployment of non-skilled workers</p> <p>Sets out guidelines to deal with tenders offering a wage rate below the mandatory wage requirement in tender offers</p>
12. FC4/2006	Tightened Measures on the Management of Service Contractors	27 April 2006	<p>Applies to tenders for service contracts (excluding construction service contracts) that rely heavily on the deployment of non-skilled workers invited on or after 1 May 2006</p> <p>Tightens up the mandatory requirements for tender assessment and management of service contracts by reducing the number of convictions to one and demerit points to three. In other words, tender offers from contractors who are found to have one conviction under the specified Ordinances or three demerit points issued for breaches of specified contractual obligations shall not be considered; and termination of contracts on account of the conviction and demerit points as specified is required</p>

3 BALANCING COMPETITION AND COMPLIANCE WITH THE WTO GPA

3.1 Introduction

The objective of the developed country members of the WTO is to provide an open and fair competitive environment amongst domestic and foreign contractors by implementing procedures designed to ensure all bidders are treated on an equal footing.

Since 20 May 1997, Hong Kong has committed to adhere to the WTO GPA and all government departments must adopt non-discriminatory procurement practices to comply with the WTO GPA requirements. The corresponding tendering practices and procedures are stipulated in Financial Circular No. 10/97.

This chapter outlines the typical challenges faced by departments in achieving a balance between effective competition and compliance with the WTO GPA and advises how to address these challenges.

3.2 Typical Challenges Faced by Departments

Departments often find it difficult to decide whether or not a service tender should be governed outright by the WTO GPA, in particular for mixed services in which some parts of the combined services are covered by the WTO GPA and other parts are not.

3.3 Guideline 1: Determine What Types of Services Fall Under the WTO GPA

The WTO GPA has specified in Hong Kong's Annex 4 of Appendix 1 to the WTO GPA the services (based on the United Nations Central Product Classification (CPC) code) and threshold values that it governs. Departments should fully understand its requirements:

- ◆ The threshold is Special Drawing Rights (SDR)^{Note} 130,000¹ for government purchases of goods and services summarised in Figure 2.

In other words, if the value of the services covered by Hong Kong's Annex 4 of the Appendix 1 exceeds SDR130,000, the tender will be governed by the WTO GPA.

Only certain specific types of services are covered, therefore the Code No. under the CPC Code on Goods and Services should be stated to avoid misunderstanding. The Department of Justice (DoJ) should be consulted where necessary on whether certain services should be covered.

Once it is determined that a tender falls within the scope of the WTO GPA, the procuring department is required by the WTO GPA to include a statement to that effect in the tender document (see Example 1).

¹ For the years of 2006 and 2007, the threshold for services listed in Annex 4 is estimated at about HKD1.5 million. The threshold for construction services listed in Annex 5 is SDR5 million which is equivalent to HKD57.636 million for the years of 2006 and 2007.
Note : See glossary

Figure 2 – List of services covered by the WTO GPA

1. Computer and Related Services:
 - ◆ Database and processing services;
 - ◆ Maintenance and repair service for office machinery and equipment including computers;
 - ◆ Other computer services.
 2. Rental/Leasing Services Without Operators:
 - ◆ Relating to ships;
 - ◆ Relating to aircraft;
 - ◆ Relating to other transport equipment;
 - ◆ Relating to other machinery and equipment.
 3. Other Business Services:
 - ◆ Maintenance and repair of equipment (not including maritime vessels, aircraft or other transport equipment);
 - ◆ Market research and public opinion polling services;
 - ◆ Security services;
 - ◆ Building-cleaning services;
 - ◆ Advertising services.
 4. Courier Services
 5. Telecommunications Services:
 - ◆ Value-added telecommunications services;
 - ◆ Basic telecommunications services;
 - ◆ Telecommunications-related services.
 6. Environmental Services:
 - ◆ Sewage services;
 - ◆ Refuse disposal services.
 7. Financial Services:
 - ◆ All insurance and insurance-related services;
 - ◆ Banking and other financial services.
 8. Transport Services:
 - ◆ Air transportation services;
(excluding transportation of mail);
 - ◆ Road transport services.
- * Refer to the relevant CPC Code in Hong Kong's Annex 4 of Appendix 1 to the WTO GPA and the General Notes to Appendix 1.

Example 1 – Requirements for WTO GPA compliance need to be stipulated clearly

In the tender document for a department's programme to outsource data centre services, the following requirements have been specified in the "conditions of tender":

- 30.1 This tender is governed by the Agreement on Government Procurement of the World Trade Organisation (WTO GPA). Tenderers are requested to note that a Review Body on Bid Challenges under the WTO GPA (the Review Body) has been set up by the Government to deal with challenges made against alleged breaches of the WTO GPA and the relevant procedures for handling bid challenges are set out in the Rules of Operation of the Review Body which are available for inspection at the Secretariat of the Review Body located at the Trade and Industry Department or which may be sent to the interested parties upon request;
- 30.2 In the event that a tenderer believes that a breach of the WTO GPA has occurred, the tenderer may, within ten (10) working days after he/she knew or reasonably should have known the basis of the challenge, lodge a challenge to the Review Body on the alleged breaches of the WTO GPA. Nevertheless, the tenderer is encouraged to seek resolution of its complaint in consultation with the procuring department before lodging a complaint to the Review Body. In such instances, the procuring department will accord impartial and timely consideration to any such complaint, in a manner that is not prejudicial to obtaining corrective measures through the Review Body;
- 30.3 The tenderers should also note that the Review Body may receive and consider a late challenge but a challenge will not be considered if it is filed later than thirty (30) working days after the basis of the challenge is known or reasonably should have been known.

3.4 Guideline 2: Beware of Other Provisions under the WTO GPA

3.4.1 Understand WTO GPA's mixed goods and services bundling

While departments have flexibility in packaging and bundling goods and services into a single contract, they should understand the coverage of the WTO GPA on mixed contracts.

The methodology for determining whether a tender of mixed nature is covered by the WTO GPA is:

- ◆ For a tender of mixed services
 - The services required by a department should be broken down by reference to the relevant CPC Code;
 - The value of services that are covered by Hong Kong's Annex 4 of Appendix 1 to the WTO GPA should be determined and added up;
 - The tender would be covered by the WTO GPA if:
 - The aggregate value of services covered by Hong Kong's Annex 4 of Appendix 1 exceeds SDR 130,000; and
 - Such value is greater than the aggregate value of services NOT covered by Hong Kong's Annex 4 of Appendix 1.
- ◆ For a tender of mixed goods and services
 - The tender of mixed goods and services is a goods contract and is covered by the WTO GPA where:
 - The aggregate value of the goods element of the tender exceeds SDR 130,000; and
 - The aggregate value of the goods element of the tender is equal to or greater than the aggregate value of the services element (including services NOT covered by Hong Kong's Annex 4 of Appendix 1).

- ◆ The tender of mixed goods and services is a services contract and is covered by the WTO GPA where:
 - The aggregate value of the services element of the tender is greater than the aggregate value of the goods element; and
 - The aggregate value of services covered by Hong Kong's Annex 4 of Appendix 1 exceeds SDR 130,000; and
 - Such value is greater than the aggregate value of services NOT covered by Hong Kong's Annex 4 of Appendix 1.

However, departments should not manipulate the scope of outsourcing with an intention to lower the value of the resulting contracts to fall below the WTO GPA thresholds.

Tenders should not be deliberately structured to sidestep the discipline imposed by the WTO GPA.

3.4.2 Be familiar with the WTO GPA restrictions

The gist of the WTO GPA is to drive market access and enhance the transparency of governments' procurement processes. Departments must fully understand the restrictions on the service bidding process from invitation to contract award.

Tendering procedures must be applied in a non-discriminatory manner and be consistent with Articles VII through XVI of the WTO GPA.

Nonetheless, derogation from the provisions of the WTO GPA may be permitted where there are concerns with security, public order and any other overriding public interest considerations. FSTB and/or the International Law Division of the DoJ should be consulted if departments contemplate the use of any of these exceptions in view of the need to ensure that any exception made is based on well-founded reasons and supporting evidence.

It is in the government's best interest that the number of bidders should be maximised as far as possible, so as to enhance competition and avoid monopoly or oligopoly situations. However, it may not be consistent with the WTO GPA if a tender condition is introduced limiting the number of contracts to be awarded to a single supplier. Where such a tender condition is considered to be desirable, advice from the International Law Division of the DoJ should be sought.

3.5 Guideline 3: Seek Advice from the DoJ and Other Relevant Authorities

Since the WTO GPA-related provisions carry legal implications and are subject to redress by way of bid challenges, departments should seek advice from the DoJ. Where a problem cannot be resolved by referring to the Q and As on WTO GPA (see Figure 1, page 8) prepared by the International Law Division of the DoJ, they may also seek advice direct from the DoJ and from any other relevant authorities such as the FSTB or the Central Tender Board if necessary at all stages of the procurement process.

4 PROPERLY ALLOCATING ROLES WITHIN A DEPARTMENT

4.1 Introduction

Many departments have a headquarters with operations geographically spread across regions or districts in Hong Kong. The headquarters and the district offices have different roles to play in an outsourcing project.

This chapter describes the challenges related to the division of roles between districts and headquarters and suggests how different parties in the same department can effectively work together in outsourcing projects.

For departments without the headquarters-district offices structure, they should consider interpreting and applying similar concepts to their organisation and where necessary, consult relevant authorities such as the EU, the FSTB's Tender Division and the Government Logistics Department (GLD).

4.2 Typical Challenges Faced by Departments

The EU's 2005-2006 Outsourcing Review revealed that a few departments have adopted the centralised approach to contract development and procurement i.e. the headquarters manages the outsourcing procurement process while district offices provide specific requirements for the service specifications. However, for some departments, because of insufficient communication, different district offices may have adopted different practices and yardsticks even if similar services have already been outsourced in other districts. This results in unnecessary duplication of resources and may mean that best practices are not uniformly used throughout the department.

Defining the roles and responsibilities within a department is one of the challenges encountered by departments during the initial stage of outsourcing. Another challenge is to ensure that the knowledge of frontline staff is utilised especially during the formulation of the requirements and the allocation of risks.

4.3 Guideline 4: Ensure Good Internal Departmental Communication

Departments should strengthen communication between their headquarters and district offices in relation to outsourcing projects. District offices should start a dialogue with their headquarters before investing substantial effort in outsourcing activities, and continue to communicate details of challenges and successes throughout the outsourcing exercise. Districts should both take advantage of the headquarters' outsourcing experience and materials, as well as contributing to it. This is particularly important when similar services have already been outsourced by the headquarters or other districts of the same department because:

- ◆ Duplication of effort in common tasks can be reduced through sharing of outsourcing materials (e.g. service specifications, contractual terms and conditions);
- ◆ Development of common procurement strategy and risk assessment can be done;
- ◆ Purchasing power can be pooled together to bargain for better prices from potential contractors – for example, the headquarters can consider coordinating the timing of outsourcing contracts, bundling similar services for different districts together, or encouraging the market by publishing potential upcoming business opportunities.

4.4 Guideline 5: Clearly Define Departmental Roles

During different stages of the outsourcing process, the headquarters can serve as a centre of excellence in outsourcing – providing relevant policy, guidance and frameworks to the district offices, advising on outsourcing best practices and encouraging continuous improvement. Meanwhile the district offices can develop their own business requirements for specific contracts and manage the ongoing contractor relationship after contract award.

A sample allocation of roles and responsibilities is detailed in Appendix A. Departments should consider the nature and complexity of the services to be outsourced and apply roles and responsibilities on a project-by-project basis.

To facilitate ongoing contract and project management at the working level, the roles and responsibilities of contract managers and frontline supervisors should also be clearly defined and communicated across the department. Figure 3 illustrates the typical allocation of roles and responsibilities, which can be applied to both situations where the contract managers and frontline supervisors come from within the same district for smaller contracts, or from the headquarters and from other districts, respectively, for larger contracts.

Figure 3 – Key roles and responsibilities of contract managers and frontline supervisors

Contract manager	Frontline supervisor
<ul style="list-style-type: none"> ◆ Chairs a service governance group ◆ Meets the contractor’s contract manager periodically to discuss progress/problems ◆ Reviews the contractor’s reports, performance data and other management information ◆ Coordinates communications and actions with the contractor’s contract manager, users, relevant government personnel and other concerned stakeholders such as the Mandatory Provident Fund Schemes Authority (MPFA) and trade unions ◆ Issues requests for government-initiated changes/ requests with the contractor’s contract manager ◆ Issues orders according to the contract ◆ Verifies and certifies the contractor’s invoice for payment ◆ Commissions and receives reports from users on the quality of services provided and their expected future usage ◆ Manages major issues and risks related to the contract or relationship with the contractors (e.g. dispute resolution) ◆ Escalates unresolved issues and risks to senior management, governance bodies and relevant stakeholders 	<ul style="list-style-type: none"> ◆ Observes and monitors the service performance on a regular basis to verify if the contractor has performed its obligations ◆ Raises performance issues with the contractor’s contract manager/supervisor, identifies and implements solutions ◆ Handles enquiries and resolves issues raised by the customers/users, contractor and workers engaged by the contractor immediately and as far as possible ◆ Escalates unresolved issues to the contract managers promptly ◆ Builds rapport and understanding ◆ Suggests improvements to the contractor and explains departmental policies and practices

5 DIFFERENT BUSINESS MODELS AND EXTERNAL OUTSOURCING EXPERTISE

5.1 Introduction

At the start of an outsourcing project, one of the key steps is to define the scope and business model. This chapter describes the challenges in defining the business models and how departments could address them.

5.2 Typical Challenges faced by Departments

Choosing the optimum business model is important because it will determine whether the outsourcing invitation will attract high quality, credible and experienced contractors or not. Departments face challenges in developing optimal business models and obtaining adequate, dedicated and experienced in-house expertise for their outsourcing projects.

5.3 Guideline 6: Analyse Options to Select Optimum Business Model²

Before deciding what to outsource, departments should step back and understand the whole function in question and its underlying processes. This can be done by first listing all key processes undertaken by the function, understanding the ownership and flow of the main processes and identifying key issues. Departments should then examine whether those issues can be addressed by outsourcing, and explore the feasibility, pros and cons of outsourcing the associated processes.

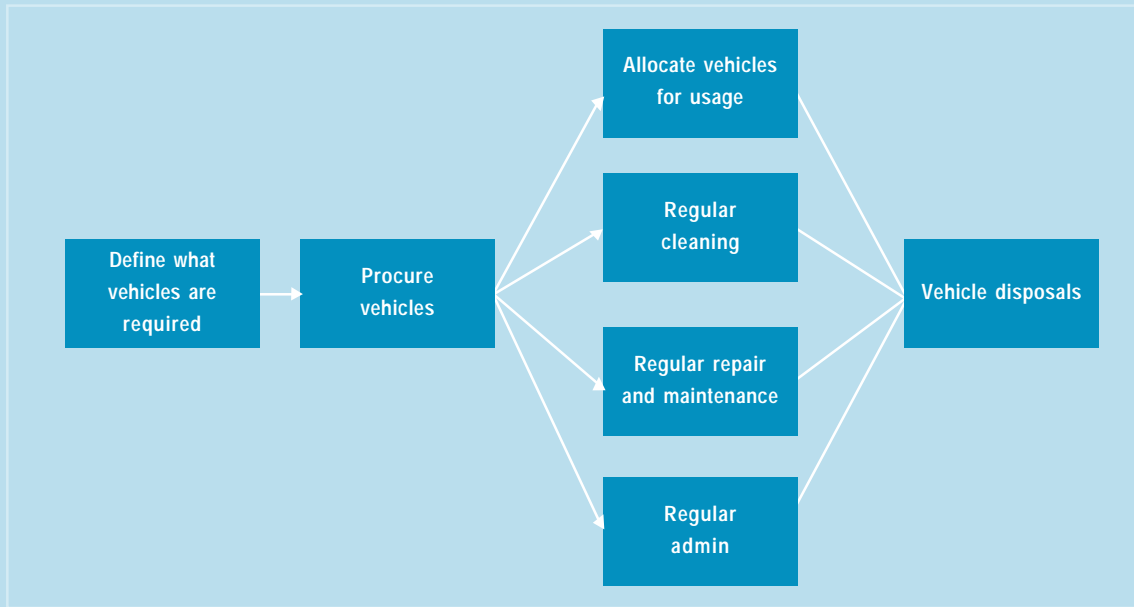
Departments should examine the possible scope of outsourcing, some options are:

- ◆ Outsourcing some of the non-core processes of the function (see option 1 in Example 3);
- ◆ Retaining only the requirement definition decisions in-house and outsourcing all non-core processes (see option 2 in Example 3);
- ◆ Outsourcing all processes of the function (see option 3 in Example 3).

² Readers may wish to note that the EU intends to publish a separate and more detailed guide on how to develop the business case in 2007-08.

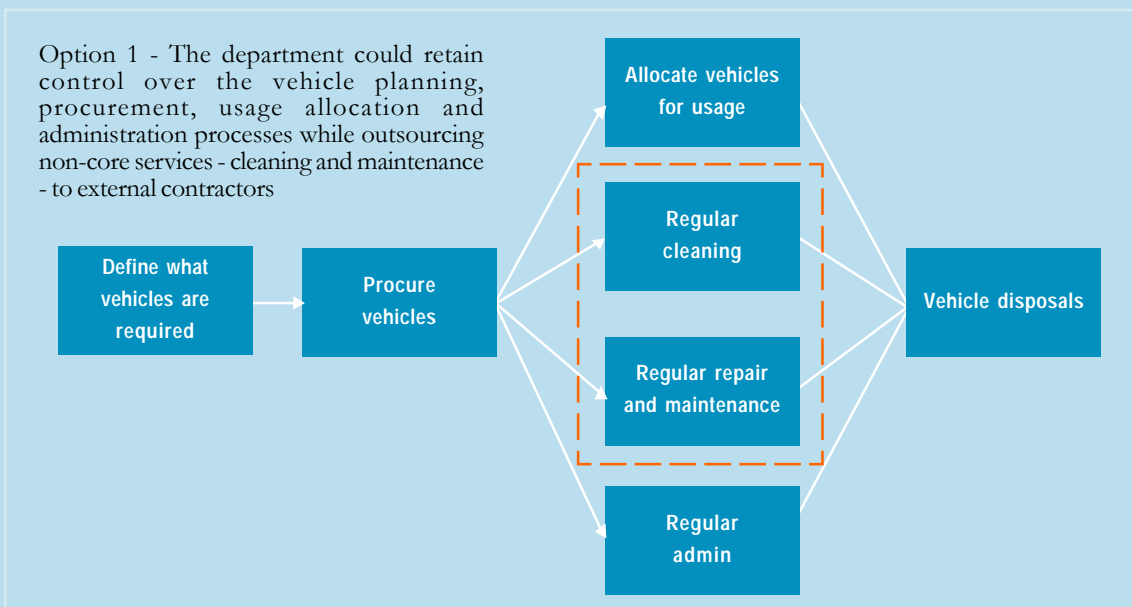
Example 2 – Understand the entire function to help decide the optimal scope of outsourcing

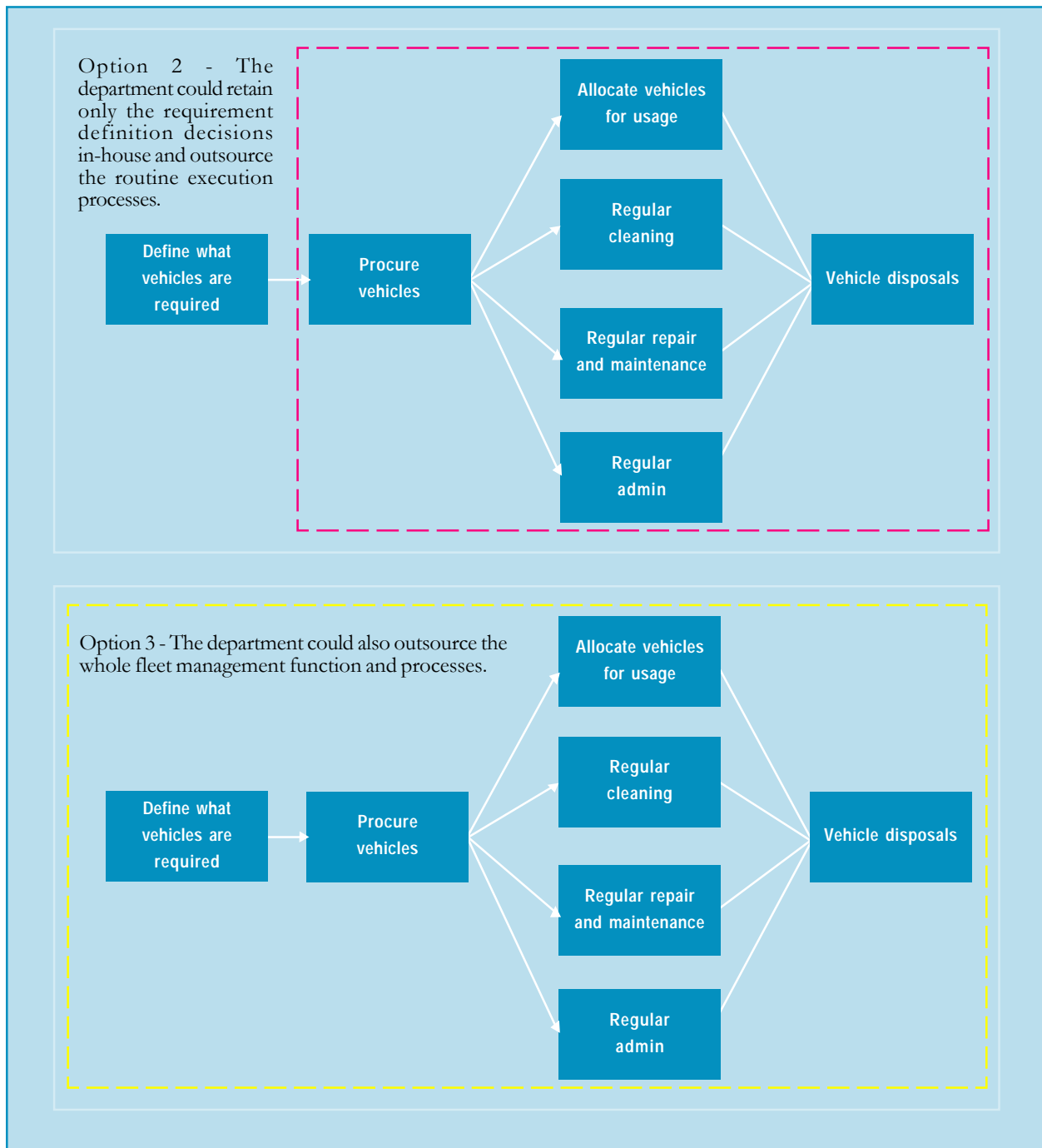
Department A intended to outsource its fleet management function and was exploring what services could be outsourced. It first mapped out the key processes of the entire function in process maps as shown in the diagram below, and then reviewed the in-house capability, existing issues and possible advantages of outsourcing/retaining each process in-house.



Example 3 – Different scope of outsourcing options should be considered involving some or all of the function

Taking the fleet management function as an example, Department A formulated different options as illustrated in the diagrams below and examined the feasibility of each option.



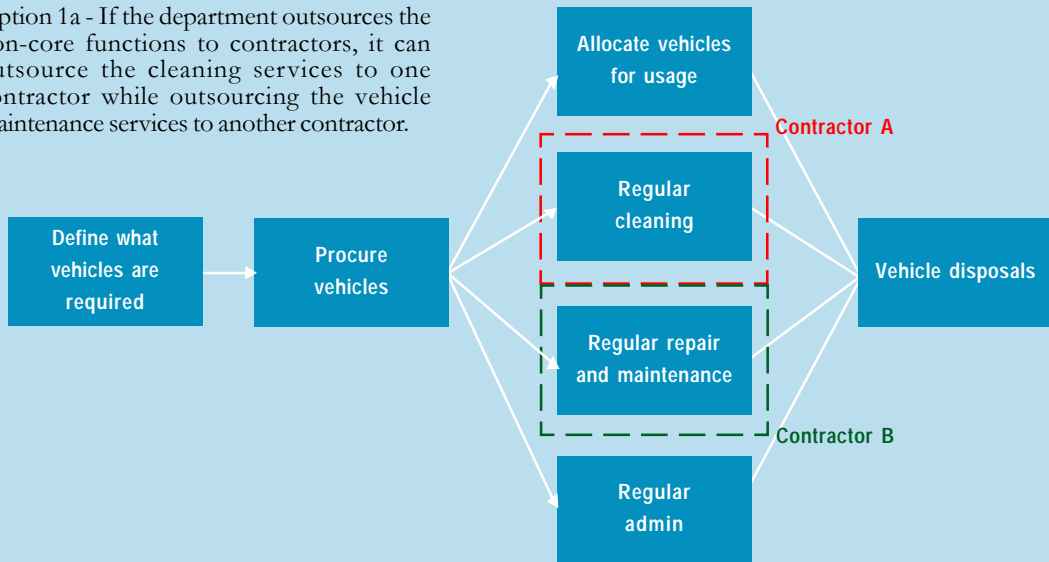


For those services that are being considered for outsourcing, departments should next examine how the contract should be structured and what their future roles would be after outsourcing. For example, does the department want to manage multiple contracts for various services, or does it want to receive total service from one single contractor and hence manage one single contract? Example 4 illustrates two possible options that a department could consider when there are multiple services to be outsourced.

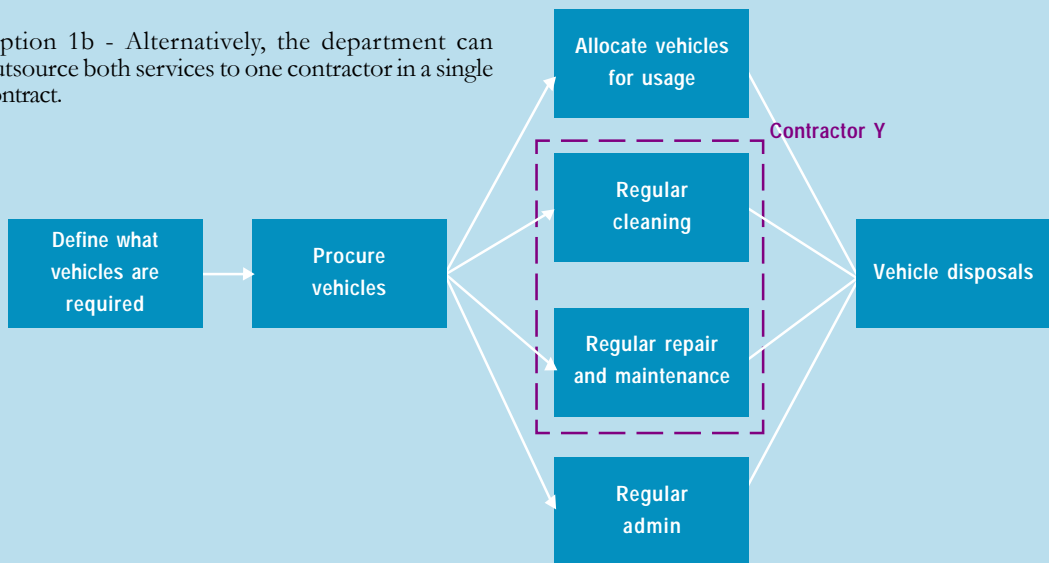
Example 4 – The scope of outsourcing should consider the number of contractors (i.e. single or multiple contractors) required

For each option given in the above fleet management example, Department A further considered whether the proposed service scope should be outsourced to a single contractor or multiple contractors. To answer this question, the department had to understand whether the proposed scope would be too big for the market to handle, or whether the opportunities would be commercially attractive to them.

Option 1a - If the department outsources the non-core functions to contractors, it can outsource the cleaning services to one contractor while outsourcing the vehicle maintenance services to another contractor.



Option 1b - Alternatively, the department can outsource both services to one contractor in a single contract.



A spectrum of possible business model options will arise, each with a different scope. As can be seen from Examples 5 and 6, different models have been successfully adopted by various governments for different types of services. There are no hard and fast rules as to the choice of business models. For each possible option departments should examine:

- ◆ The existing underlying costs and the benefits;
- ◆ The pros and cons of outsourcing to a single or multiple contractors, and whether there are synergies of operation for having a single contractor operating multiple services;
- ◆ The implications to departments themselves, their customers, the public, the contractors as well as any other stakeholders.

In addition, departments should also review market capabilities when examining the possible scope of outsourcing. For instance, while it may be easier for departments to manage fewer but larger contracts instead of multiple small contracts, the outsourced services might potentially be at risk if the contractors did not have the required skills and capability. Conversely, potential contractors may not be interested in outsourcing contracts with a limited scope of work. Departments should therefore strike a balance between the ease of contract management, market capability and interests as well as the risks involved.

Example 5 – Different business models may be used for similar services depending on policy objectives

The Australian government enacted the National Competition Policy in 1995, which prohibits anti-competitive conduct and applies to all government businesses and unincorporated enterprises, including local government. Councils may thus seek bids from contractors such as private businesses, sports associations, not-for-profit organisations and a range of community based groups to deliver public leisure services on their behalf. Discreet individual services such as cleaning services or leisure programmes may be outsourced, if cost efficiency and better quality can be demonstrated by the private operators. As a result, some leisure services were outsourced and managed under various business models. Some examples were:

In-house competitive bid - In the *City of Merville*, the in-house bidding units of the local council won all management contracts for the leisure centres following competitive tendering. All recreation centres were run by these in-house units on a commercial basis. Only non-core services such as catering and kiosks were contracted out.

Management agreement - The *YMCA* manages about 170 sports complexes across Australia. The model was based on a management agreement with the local authorities, as opposed to a leasehold arrangement. In this way, the YMCA undertook to run the facility and did not have to bear any potential increases in lease charges. As part of a typical agreement, the YMCA team reported to a committee composed of local government representatives, YMCA managers and relevant sports officers. Service fees are paid on a minimum fixed rate plus performance bonus.

Leasing and revenue sharing - In Melbourne, the Harold Holt Swimming Centre was run by RANS, a private company specialising in leisure, entertainment, art and meeting facilities management and marketing. In addition to paying the local authority an annual rent of Aus\$220,000, RANS invested a further Aus\$300,000 - 400,000 to improve facilities at the centre. It was expected that the modernised centre would generate an average turnover of Aus\$350,000 per year.

Example 6 – Other business models were adopted to outsource public leisure services

The United Kingdom Government has been outsourcing public services including leisure services since the 1980s as a result of the **Compulsory Competitive Tendering** legislation introduced to open up the public sector to private sector participation. Examples of three outsourcing approaches are presented below.

Employee ownership – In 1993, Greenwich Leisure Limited was formed as a non-profit employee ownership co-operative following a cut in central government funding. Under this arrangement, the company controls staff conditions, recruitment, pricing and leisure programmes and the Council owns the buildings and assesses the provision of leisure services. Whilst the company is required to sustain a profitable business, the Council provides a building lease annual grant to cover the financial shortfall. After the implementation of this model, the annual sports centre income doubled in five years while council financial support reduced from £2.5m a year to £1.5m. Furthermore, £1m of profit was set aside for improving facilities each year.

Management services – Glendale Managed Services Ltd managed parks, open spaces and leisure complexes on behalf of local authorities and the private sector. The grounds management division managed cricket pitches, bowling greens, tennis courts, playgrounds, football/hockey/rugby pitches, shrub beds, rose beds, carpet bedding, river/waterways, schools, highways, housing, etc. Meanwhile, its leisure division ran leisure centres on behalf of local authorities and the private sector.

PPPs – Leisure Connection had been providing comprehensive facilities management services to more than 50 local authorities involving over 100 separate sites and taking 30% of the public leisure market. In some cases these were operated as strategic partnerships, e.g. Wokingham Council formed a partnership with Leisure Connection, signing a 16-year PPP contract in May 1999.

5.4 Guideline 7: Consider Using External Outsourcing Expertise

For sophisticated and complex outsourcing projects, departments may not have all the necessary skills and expertise required to manage the whole or part of the procurement process. In such situations, it may be more effective and efficient to bring in specialist consultants with relevant knowledge and experience to assist in areas such as:

- ◆ Structuring the optimum outsourcing scope and business model;
- ◆ Formulating the service specifications, performance management and measurement regime and the payment structure;
- ◆ Determining the pricing model and developing the business case;
- ◆ Assisting the Evaluation Panel in its evaluation of the bid responses and contract negotiation;
- ◆ Performing due diligence on bidders;
- ◆ Assisting in the transition of services.

However, departments should be alert to any possible conflict of interest in the procurement process. Departments may need to consider if the consultants supporting the procurement process should be debarred from bidding for the services to be outsourced. Departments should refer to paragraphs 190-195 of SPR for details.

Example 7 – Consultancy support for outsourcing of data centres

In line with the government's strategic direction to outsource, Department A decided to outsource its data centre operations to improve efficiency and effectiveness and to foster the growth of local industry. A specialist outsourcing consultant was therefore engaged to support the end-to-end procurement and implementation process from market testing, formulation of the asset transfer and human resources model, preparation of request for proposals (RFP), tender evaluation, through to contract negotiation and transition implementation.

6 DEFINING ATTRACTIVE COMMERCIAL ARRANGEMENTS

6.1 Introduction

It is in the Government's interest to define attractive commercial arrangements in order to secure the best value-for-money outsourcing contracts. This chapter describes typical challenges in defining commercial arrangements for outsourced services and advises on how to tackle them. General contract considerations are addressed in Section 7.4.

6.2 Typical Challenges Faced by Departments

When defining commercial outsourcing arrangements, departments sometimes:

- ◆ Transfer too many risks to contractors;
- ◆ Structure less attractive commercial arrangements (e.g. short contract duration, small contract size) or overly use contract terms where not absolutely necessary (e.g. unlimited liabilities, time of essence).

Unattractive commercial arrangements may drive the most appropriate potential contractors away, as they can explore business opportunities elsewhere – e.g. working with the private sector, other departments locally or overseas – where profitability is higher. Departments' best interests may sometimes be best served by being less aggressive in seeking to maximise the risk transfer to contractors or achieving the lowest cost bids.

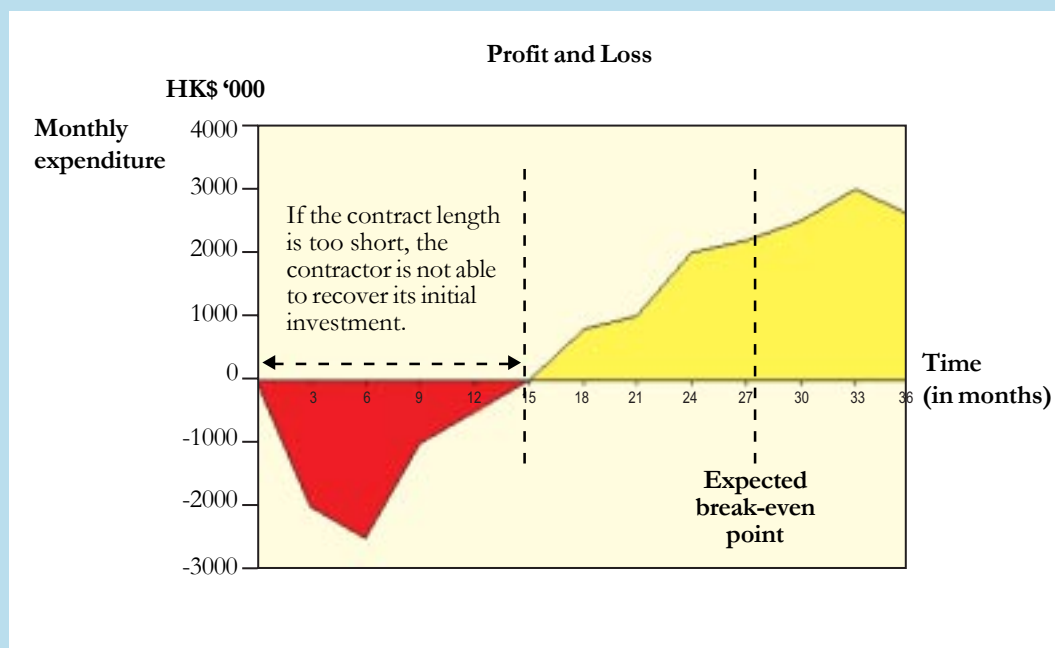
6.3 Guideline 8: Consider Establishing Sufficiently Long Contract Terms

Contractors may sometimes need to recruit additional staff or commit heavy capital investments upfront to deliver the committed services. Best value for money may be achieved if the contract period is linked to the life of the major assets, allowing the capital costs to be amortised over an appropriate period. The contract period should be long enough for contractors to recuperate investments (in both equipment/technology and human resources) and achieve reasonable profits; otherwise potential contractors may simply choose not to bid if they believe the contracts would not be financially viable (see Example 8). Longer contracts also facilitate the development of partnership relationships between government and contractors.

Example 8 – Contractors may not bid for contracts with short durations

In a global financial institution's outsourcing tender for data centre services, potential bidders expected it would take more than a year to develop new systems because of the size and complexity of the project. However, the contract length defined was not long enough for the successful contractor to recover its investment. As a result, many potential bidders chose not to bid and the global financial institution did not receive enough responses from the market.

The relationship between the recovery of investment and the length of contract is illustrated in the diagram below:



When deciding on the contract period, departments should also consider the transition effort and best practices in the market. They should consider the tendering lead time for contract renewal and the amount of time it will take to prepare a new tender and select a new contractor upon contract expiry (Chapter 14 advises on contract expiry).

However, departments should be careful not to commit to a contract period that is too long, especially when the market average prices for the services concerned will likely decrease in the medium or longer term. In these cases, a shorter contract will allow departments to look for more value-for-money services or technological advancements upon contract expiry.

If departments have good reasons for long term contracts, they should build appropriate break clause options into them (see Example 9). This will enable departments to terminate them prior to normal expiry. With long term contracts departments also need to consider incorporating change management mechanisms for any service and price adjustments during the contract period (Section 7.5 advises on provision for variations).

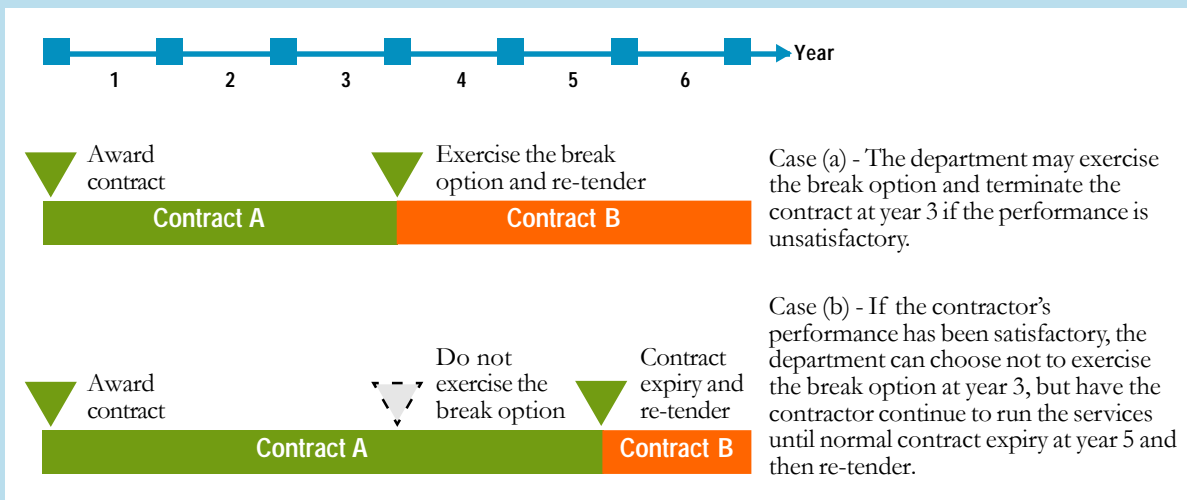
Example 9 – Break clauses in long contracts help incentivise contractors and provide flexibility to departments

Department A had a five-year outsourcing contract with a break option at the end of year three. It worked as follows:

During year three, Department A would review the performance of the contractor. If the contractor's performance was:

- ♦ Unsatisfactory - Department A could exercise the break option at the end of year three to terminate the contract. It could then launch a new tendering process and engage a new contractor (see case a);
- ♦ Satisfactory - the contractor could continue to operate the services until year five (see case b).

Such arrangements will not only help to attract contractors to bid for the contracts, but also incentivise the successful contractor to continually deliver quality services throughout the life of the contract.



Exercising contract extensions without issuing a new tender is usually undesirable because departments may lose opportunities to seek potentially better offers from the market. It also denies other contractors the opportunity to participate in government work. SPR 520(c) stipulates that any contract extension must be subject to appropriate prior approval.

6.4 Guideline 9: Incentivise Contractors by Stressing the Importance of Past Performance

Departments can incentivise contractors by taking past performance into account during tender evaluation (Chapter 8 advises on formulating marking schemes) provided that other contractors will not be put into an unfair position. Contractors should understand that their past or present performance – whether good or bad – will affect their chance of winning contracts in the future.

Example 10 – Taking past performance into account in future tendering exercises will incentivise contractors to perform well at all times

In the tender evaluation for a property management contract, “past performance” accounted for 36% of the total technical score. The contractors’ opportunity to be invited to tender in the next quarter would be allocated as follows.

Performance score	Opportunity for tender invitation in next quarter
Top 25%	Full
Middle 50%	Partial
Bottom 25%	None

Seventy-five percent of the existing contractors would become the pre-qualified property services agents and would be invited to bid for future contracts while the poor performers (bottom 25%) would be removed from the invitation list.

This arrangement served to encourage contractors to deliver good performance consistently and also promoted performance competition among all players in the market. Meanwhile, departments should ensure the existing contractors’ performance is assessed on an objective basis along with a clear differentiation between the levels of performance (e.g. using a rating scale, instead of a simple pass-fail score). It is definitely worthwhile for departments which have frequent tendering exercises. Departments intending to implement such an arrangement may wish to consult the DoJ on the possible WTO GPA implications.

6.5 Guideline 10: Consider Different Pricing Models

Departments can attract contractors by adopting appropriate pricing models. They could conduct market testing or Expression of Interest (EoI) exercises on a no commitment basis and ensure they understand the various pricing practices in the market. These actions also serve to encourage the market and create a market environment where contractors are well prepared to develop high quality proposals during the tendering stage.

During the market consultation stage, however, departments must exercise care to ensure that impartiality is maintained and no perceived advantages are given to any particular contractors. Departments should consult the Independent Commission Against Corruption (ICAC) on the procedures for departmental officers to discuss with market players to avoid them from being improperly influenced.

One pricing model is to have a fixed component and a variable component. In this case, the variable component should be a substantial amount, linked with the contractor’s performance through objective performance measures (Chapter 9 advises on performance management), and/or scaled with time and volume, and facilitated by appropriate statistical sampling methods.

Departments should agree the pricing model and performance measurement mechanisms with the contractor upfront and ensure they are built into the contract. Performance scores should also be graded using a pre-defined rating scale. Although there are merits in linking price with performance, departments should be aware of the risks associated with performance-based payment methods (e.g. subjective or inconsistent rating of performance amongst different users for service contracts involving a number of venues and users) and ensure that measures to guard against performance manipulation are put in place.

Other common pricing techniques include:

- ◆ Paying bonuses only when service performance targets are exceeded;
- ◆ Sharing gains between government and contractors from the streamlined, improved services (see Example 11). Departments should note that any proposal for sharing of gains between government and the contractors must be consistent with the Public Finance Ordinance (Cap 2). Government's share will form part of General Revenue and there must not be any sharing of General Revenue (as defined for the purposes of the Public Finance Ordinance).

Example 11 – 'Gain sharing' is a pricing model that enables both parties to share returns

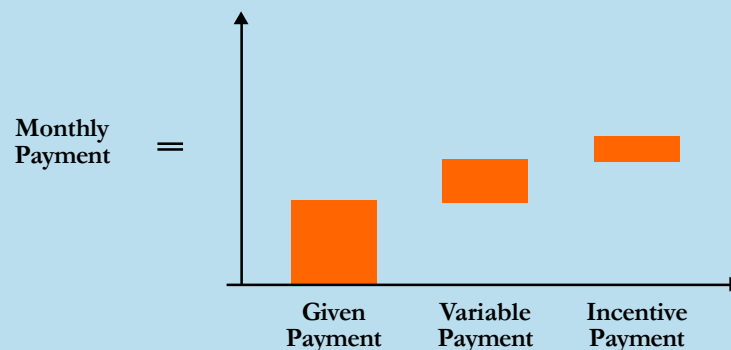
A European government department intended to encourage a contractor to improve efficiencies and had aggressively managed its cost in an outsourcing service contract. A 'gain-sharing' pricing model was proposed by the government to share any such benefits with the contractor. As a general rule, any excess profits over and above the margins set out in the predefined financial model would be shared between the government and the contractor on a 70:30 ratio for the first three years, while all excess profits afterwards would revert to the government.

A hybrid pricing model combining some of the above pricing techniques can also be devised to match the specific needs of an outsourcing contract, so as to balance the interests of the government and the need to attract potential contractors (see Examples 12 and 13). Departments should also build in provisions for price adjustment as a result of any change or expansion of scope (e.g. via service variation or other means) during the contract period (Section 7.5 advises on provision for variations). Nevertheless, departments should be aware of the risks associated with pricing models and potential variations that will be borne by contractors, which might in turn drive up tender prices.

Example 12 – Combinations of different payment techniques can be adopted

A payment mechanism from a European government department's customer service contract was structured in such a way that the monthly payment for the outsourced service consisted of three elements:

- ◆ A fixed payment – the fixed portion that would not vary unless scope changed;
- ◆ A variable payment – the portion that would vary according to the volume of transactions dealt with on a per unit price basis for processes such as 'enquiry handling';
- ◆ An incentive payment – the portion that would be paid when the contractor exceeded the service performance targets.



Example 13 – Different pricing models may fit different scopes of services

Depending on the nature and type of services to be outsourced, different pricing models could be considered and some models would be more attractive to contractors than others in each case. For example, a leisure services-related department found, from the market, that there were a few preferred market models for related services as shown below:

Possible scope of outsourcing services	Typical pricing models
Management services for an entire leisure/sports complex	Fixed service fees with incentive bonus
Fitness equipment maintenance/cleaning/horticultural/security services	Fixed service fees
Ancillary services such as catering and merchandising	Leasing and revenue sharing

6.6 Guideline 11: Consider Bundling Services in a Single Contract

Contract size is another important factor that affects the interest of potential bidders. Departments should consider bundling logically related services into a single, sizeable contract. Theoretically speaking, the larger the contract size, the more attractive it is to potential contractors - as long as departments can justify the pros and cons as well as the risks involved. Examples of bundled service contracts are given in Examples 14 to 16.

When departments are determining the contract size, they should consider whether there will be fair competition in the marketplace and whether there will always be potential contractors who can serve as backup contractors in case the winning contractor failed to perform or went bankrupt. Departments should also consider the criticality of the service availability and define a back-up mechanism (e.g. switch to other potential contractor(s)).

Reasonably sizable contracts with logically bundled services will benefit both departments and contractors in many ways, e.g.:

- ◆ Attracting capable and credible bidders;
- ◆ Encouraging contractors to invest in equipment, technology and people to deliver quality services;
- ◆ Getting better value-for-money services from the bidders;
- ◆ Gaining economies of scale in contract administration and management;
- ◆ Achieving synergy in the contractors' operations.

Departments should assess the benefits of bundling services and strike a balance between the benefits and risks involved in engaging one or fewer contractors than before.

Contracts with substantial size might often attract formation of bids where there are prime and sub-contractors. Where necessary, departments should clearly define their requirements on the key elements such as the number of sub-contractors, the number of levels of sub-contractors, the obligations of sub-contractors, etc.

To mitigate the risk of heavy reliance on few contractors, departments should ensure appropriate performance management structures and mechanisms are in place to manage fewer but sizeable contracts (Chapter 9 advises on performance management).

Example 14 – Bundling multiple services into a single contract may help achieve economies of scale and improve service quality

In a property management service contract, Department A bundled a range of services including cleaning, security, frontline tenancy management and maintenance services. While the contractor could deliver better value-for-money services for the department through economies of scale in its operations, the department could also benefit from reduced costs of contract administration and management and avoidance of potential boundary issues among multiple contractors. As service quality improved, tenants’ satisfaction levels increased.

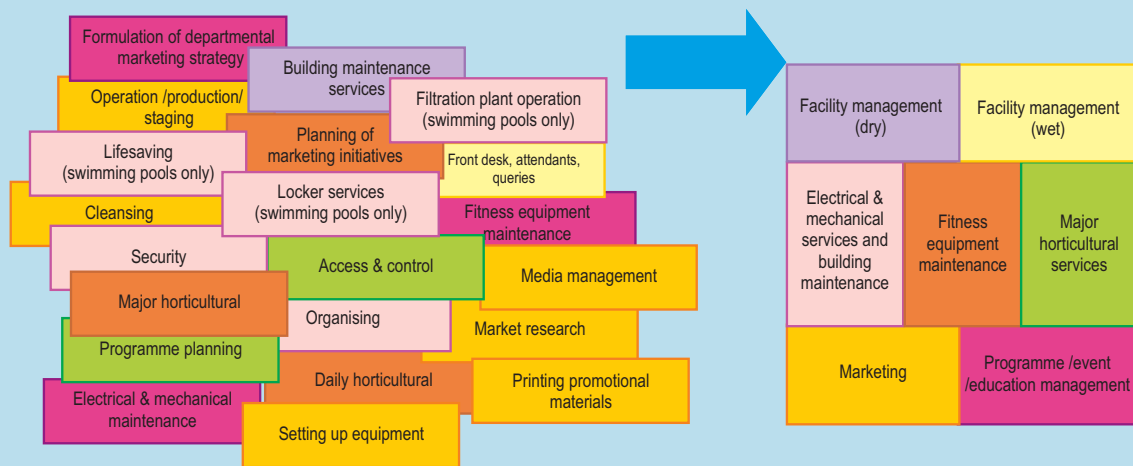
Example 15 – Construction and building maintenance services can be combined into a single contract

For an initial construction and ongoing building maintenance contract, Department A bundled the construction and maintenance services together in a single tender. It was expected that the costs would be reduced and quality improved if the contractor was responsible for both services, creating an incentive for the contractor to pay more attention to the selection and use of materials and equipment during the initial construction stage.

Example 16 – Various bundling options can be considered after identifying the full range of activities currently performed

A leisure services department managed leisure and sports facilities and operated associated services, which could be broken down into over 20 main activities. When it conducted the outsourcing feasibility study, it grouped these activities into seven bundles and studied the feasibility of each bundle.

For example, the feasibility of facility management was explored. Contractors were required to provide a comprehensive, integrated set of end-to-end processes from maintaining the facilities and equipment, providing cleaning, security, horticultural services through to marketing and delivering sports programmes for the entire leisure complex.



7 DEVELOPING HIGH QUALITY TENDER DOCUMENTATION

7.1 Introduction

Having a set of high quality outsourcing tender documentation is very important. If the service requirements are not clearly stipulated, bidders will not be able to understand the requirements and formulate appropriate proposals. This might lead to a mismatch of expectations, customer dissatisfaction or disputes during the contract period.

About 80% of the final outsourcing cost is generally determined at the service specification stage, leaving 20% to be affected by the choice of an appropriate contractor as well as the results of the subsequent tender negotiation after identifying a recommended bidder (under circumstances as listed in SPR 385(d)). Failure to stipulate and clearly specify the service requirements is often a major cause of over-budgeting and dissatisfaction.

It is, of course, essential that departments use their judgement and common sense when developing tender documents. The time and effort to be put in and the extent of perfection required will vary from one contract to another. What might be appropriate for a 10-year facilities management contract would not be needed for a two-year cleaning contract.

For large, long-term contracts in particular, best practice recommends that the contract manager be identified and involved in the contract preparation. This will help him or her to understand fully what was intended by the various clauses include in the contract, and ensure good institutional memory.

This chapter describes the typical challenges faced by departments in preparing tender documents and provides advice on how to tackle these challenges.

7.2 Typical Challenges Faced by Departments

When developing outsourcing tender documents, departments often encounter the following issues:

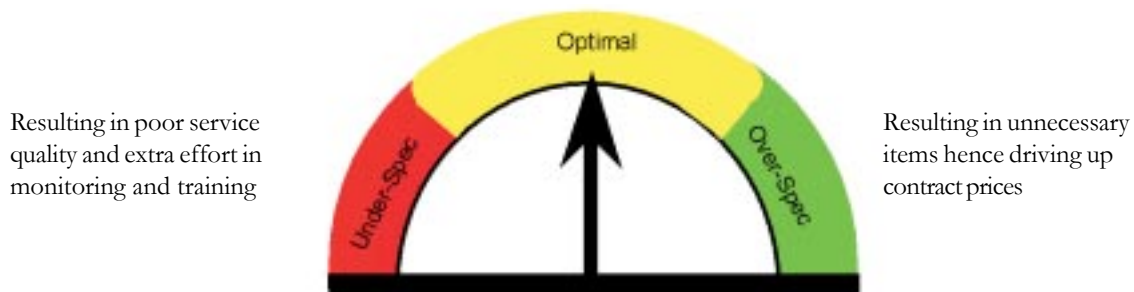
- ◆ What are the service requirements and how should they be specified?
- ◆ What kind of information should be disclosed to or sought from bidders?
- ◆ What are the departments' interests that need to be protected by the contract terms and conditions, and how?
- ◆ Are there wider government interests that need to be protected?
- ◆ What if there are future changes to the service requirements?

Without having clear answers to these questions, departments may not be able to develop a quality tender document, leading to departments experiencing some of the following:

- ◆ **Over-specification of service requirements** – which would result in non-essential services, unnecessarily high contract prices and excessive service monitoring effort from both parties;
- ◆ **Under-specification of service requirements** – which would result in misunderstanding of service requirements, mismatch of service expectations, poor service quality, and extra effort required in service monitoring and training. Any ambiguity that leaves the contractor with no real idea of what the user exactly wants or the importance attached to different attributes may be a source of subsequent disputes;

- ◆ **Input-based and over-prescriptive specifications** – which focus too much on describing the resource input requirements and the precise delivery approach. This would result in inflexibility and sub-optimal allocation of contractors’ resources;
- ◆ **Irrelevant information requests in the tender document** – which would consume not only the bidders’ extra time in preparing their tender responses, but also departments’ additional efforts in reviewing and evaluating them;
- ◆ **Insufficient information provided in the tender document** – which would consume not only departments’ and bidders’ extra time in clarifying information, but also impede bidders from providing a realistic price estimation;
- ◆ **Insufficient provisions to cater for potential service variations** – which might make it difficult to handle small changes in service requirements during the contract period of a medium to long-term contract;
- ◆ **Missing or inappropriate contract terms and conditions** – which might fail to protect the interests of the government and the general public;
- ◆ **Unnecessarily harsh contract terms and conditions** – which might reduce tender competitiveness, increase the cost of tenders and be portrayed as overprotecting the interest of government and departments;
- ◆ **Failing to provide for effective remedies and enforcement measures** against defaulting contractors which might be avoided e.g. by suitable due diligence, taking suitable representations and warranties, bonds, joint and several promises, parent company guarantees, indemnities and direct covenants from **sub**-contractors, as well as having and exercising liens and charges.

Figure 4 – The range of detail in a service specification



7.3 Guideline 12: Develop Relevant and Concise Service Specifications

A high quality service specification has three key characteristics:

- ◆ Primarily being output-based and non-prescriptive;
- ◆ Focusing on key issues and objectives to be addressed in the outsourcing initiative;
- ◆ Providing or requesting information only if it serves a well-defined purpose.

7.3.1 Structure of an output-based specification

There are different ways to define the service requirements. An input-based approach will stipulate the step-by-step procedural and resource input requirements (although it may not guarantee the outcome or its quality). An output-based approach will emphasise the desired outputs and/or outcomes regardless of the resources required or the manner in which the outcome is achieved. Applying this concept to structuring service specifications, an output based approach would allow more flexibility for contractors to consider innovative approaches and achieve the best outcomes. Examples 17 to 19 compare and contrast the differences between input-based and output-based service requirements in some outsourcing contracts.

Outsourcing best practice encourages the use of an output-based approach in service specification, i.e. describing the desired outputs/outcomes rather than “what inputs” and “how to do it”. This will give the bidders greater flexibility in proposing alternative value-for-money services to departments while achieving the same results. Departments should, however, devise a fair and transparent mechanism to evaluate the pros and cons of alternative approaches proposed by contractors.

Although output-based service specifications are preferred, departments should note that it is very difficult to prepare a 100% pure output-based specification in practice. At times it is also appropriate to specify a small number of the “what inputs” and the “how to do it” requirements in order to avoid misunderstanding and to set the right expectations.

Example 17 – Specifying requirements for design and production of identity documents

A property management company intended to provide a pocket-size water-proof smart card for all tenants. It decided to outsource the card design and production services to an external company. In its service specifications, it adopted the input-based approach for specifying the requirements for the tenants’ cards.

Meanwhile, a European government department engaged a contractor to design and produce fishing licence cards. It defined the requirements using the output-based approach in the service specification.

Some examples have been extracted from the two service specifications as shown below:

Input-based specification - a property management company	Output-based specification - a European government department
<p>Requirements:</p> <ul style="list-style-type: none"> ◆ Size = 6cm x 5cm; ◆ Thickness <=2 mm; ◆ Materials: PVC product code Xm0012345. 	<p>Requirements:</p> <ul style="list-style-type: none"> ◆ Must be legible, durable, fraud protected and practical in pocket size for external display by anglers when fishing; ◆ Dual language version (English/Welsh) must be available; ◆ Materials: PVC product code Xm0012345; ◆ The licence must contain the following minimum information - full name of licence holder and period of validity.
<p>Issues: the input-based requirements were too specific. The bidders had limited flexibility in proposing other possibly cheaper, more durable or better/more cost-effective water-proof materials. This input-based requirements specification might also prevent the property management company from asking for another type of material to be used in the future without raising a change request.</p>	<p>Benefits: an output-based specification allows the bidders to propose new designs and cost-effective solutions as long as they satisfy the outcomes required.</p>

Example 18 – Specifying requirements for street cleaning services

Department A and Department B outsourced their street cleaning services to external service operators and adopted two different approaches in specifying their requirements.

Input-based specification - Department A	Output-based specification - Department B
<p>Requirements:</p> <ul style="list-style-type: none"> ◆ Three sweepers in street ‘X’ from 6 a.m. to 8 a.m., and from 7 p.m. to 9 p.m; ◆ Four sweepers in street ‘Y’ from 6 a.m. to 8 a.m., and from 7p.m. to 9 p.m; ◆ Two drainage cleaners to clean the sewers in street ‘Y’ for emergencies; ◆ Each drainage cleaner shall be supplied with the following items: <ul style="list-style-type: none"> - 1 gear box - 1 leader hose - 2 standard drain jets 	<p>Requirements:</p> <ul style="list-style-type: none"> ◆ No litter, detritus or refuse in the street; ◆ Remove graffiti, if any; ◆ No blockages in drains and pipes; ◆ Respond to and resolve reports of dirty areas within 15 minutes.
<p>Issues: mandating the manpower inputs could lead to unsatisfactory performance in the event of an unexpected, sudden drainage blockage since the contractor needs to fulfil the input-based specification and cannot redeploy the sweepers to help solve the drainage blockage problem.</p>	<p>Benefits: since the focus was on the outcomes and outputs, the contractor had to deliver the required outputs/ outcomes regardless of the resource level required. Department B therefore need not worry about how much resources would be required by the contractor but could focus on the quality of services. This helped the department reduce its effort in monitoring compliance of requirements and eventually achieved about 16% cost savings. It was a win-win situation for all involved.</p>

7.3.2 Focus on key issues and objectives

When drafting the service specification, departments are often overwhelmed by the complexity and volume of outsourcing project activities. It is easy for them to dive straight into the detailed requirements and drift away from the key issues of existing services and original intent of the outsourcing projects.

Departments should focus on the key objectives when drafting the service specifications (see Example 20). The bidders can then understand the rationale behind the outsourcing projects, and can propose optimal solutions to address the key issues.

In particular for those services that departments have not outsourced before, it is important for departments to understand the key issues to be addressed by the outsourcing initiative. Departments should also examine each service requirement carefully and decide whether the service requirement should be provided internally or would better be placed with contractors. As service requirements cost money, departments should consider the costs and benefits of outsourcing, and restrict the scope to only those service requirements that address the key objectives and issues (Section 5.3 advises on determining the business models and service bundles).

Example 19 – Specifying requirements for handling customer complaints

Both Department A and Department B required their contractors to handle residents' complaints in their property management service contracts. Different approaches were adopted in their service specification, and some examples have been extracted and shown below:

Input-based specification - Department A	Output-based specification - Department B
<p>Requirements:</p> <ul style="list-style-type: none"> ◆ Five customer service officers operating during the office hours (9 a.m. – 5 p.m.); ◆ 10 customer service officers operating during peak hours (7 p.m. – 11 p.m.); ◆ Three customer service officers operating during the night shift; ◆ 20 phone lines allocated in a telephone switching system with a single external hotline number. 	<p>Requirements:</p> <ul style="list-style-type: none"> ◆ During the 24 x 7 window, all incoming calls, coming through a single external hotline number, must be answered within 10 seconds based on the following call volume estimation: <ul style="list-style-type: none"> - On average, 80% of daily calls were made between 7 p.m. and 11 p.m. while 60% of calls were received on Saturdays and Sundays; - the total number of calls range from a minimum of 3,000 to a maximum of 20,000 per month. ◆ When lines are busy, voice recordings of 'putting the caller on hold' messages should be played to the caller.
<p>Issues: these input-specific requirements would limit the bidders from using their resources in alternative roles or dynamic allocation of resources to handle enquires and complaints. The bidders might also tend to provide only the stipulated input resources required and charge for them even when the resources are idle, whilst paying little attention to the quality of the service provided.</p>	<p>Benefits: it becomes the bidders' responsibility to work out the resource input requirements in order to satisfy the service requirements. An output-based service specification also helps the bidders understand the service expectations and ensures that the department receives quality services from the contractor.</p>

Example 20 – Explaining clearly the outsourcing objectives will help potential bidders to develop solutions that are 'fit for purpose'

For the outsourcing of the rod fishing and navigation license management services to potential contractors, a European government department stated its objectives clearly in the first chapter of the tender document as follows:

The Environment Agency wishes to appoint a single contractor who will fully design, develop, install, own, implement, operate and maintain a cost effective system to distribute and sell a range of Rod Fishing and Navigation Licences to the general public on behalf of the agency throughout the country for a negotiable period.

The aim of this contract is to maximise income to the Environment Agency and provide rapid, detailed, accurate computerised information on both sales and licence holders which can be used for:

- ◆ Supporting enforcement;
- ◆ Market analysis and research;
- ◆ Analysis of environmental resource demand and use (e.g. fish stocks and waterway facilities) for long-term planning purposes.

Example 21 – Clear specifications will help bidders focus their solutions on the key issues and objectives

Both Department A and Department B outsourced their property management services to contractors. Their service specifications were developed with varying levels of detail and focus. Extracts from the specification are shown below:

Service specification - Department A	Service specification - Department B
<ol style="list-style-type: none"> 1. Prepare and post information and notices relating to estate location plans, details of flat type and layout, etc 2. Promulgate and act in accordance with the latest guidelines/instructions of the Employer on decoration, installation of laundry rods/nylon ropes and installation of air conditioners, etc 3. Follow up “no-show” cases including making new appointments as required 4. Show tenants/licensee’s samples of work or show flats/vacant units and the like <p>100. After completion of refurbishment work of vacant flats and upon intake of tenants, greet prospective tenants by Property Management Officers or above in the Estate Management Office. Explain the terms and conditions of Tenancy Agreement to prospective tenants including aspects on tenants’ rights and responsibilities for maintenance</p>	<ol style="list-style-type: none"> 1. Keep all public areas clean and tidy 2. Provide a safe environment for the residents through security guards and monitoring services 3. Provide a regular and ad hoc maintenance service for the buildings, pipes and windows, etc 4. Inform the residents promptly about property management related announcements (e.g. suspension of water supply, annual maintenance of gas pipes)
<p>Issues: Department A stated a long list of all tasks required from the contractor, depicting over 100 duties. It was unclear to the bidders what the key focus of the contractor services was</p>	<p>Benefits: Department B focused on a few key services and specified them clearly in the tender document. This helped the bidders understand the priority and objectives of the outsourced services</p>

Furthermore, departments should keep the service requirements concise and short, or at least provide a high level summary of service requirements when there is a long list of requirements (see Example 21). This will help ensure that the bidders have a good understanding of where to focus their effort in service delivery and will not lose track of the key objectives and issues to be addressed.

7.3.3 Provide or request information only if there is a well-defined purpose

A high quality tender document will provide information only if such information serves a well-defined purpose. Otherwise, inappropriate or irrelevant information in the tender document (see Examples 22 and 23) would distract the bidders from focusing on key tender information. Departments should also request information from the bidders only if the purpose is well-defined (see Example 24); otherwise it would cost departments unnecessary time and effort in preparing the specification or evaluating the tender responses.

A piece of information is worth including in the tender document if it:

- ◆ Is directly related to the key objectives or major issues to be addressed by the outsourcing initiative;
- ◆ States clearly the outsourcing scope (both breadth and depth);

- ◆ Describes important needs and expectations of the departments and the stakeholders of the services;
- ◆ Sets out the service performance level measures and targets, including associated definition and calculation formulas;
- ◆ Enables bidders to come up with realistic prices;
- ◆ Defines necessary touch points, constraints, roles, responsibilities and resources for contract management;
- ◆ Enables appropriate allocation of risks between both parties;
- ◆ Forms the basis upon which compliance checking, as well as technical and price evaluation, of the tender responses can be conducted (see Example 24).

Example 22 – Insufficient information in the tender document will frustrate a successful procurement exercise

In an outsourcing tender for property management services, Department A had not provided essential information such as equipment to be supplied by the government, site boundaries and the operating period of clubhouse facilities. As a result, the bidders had proposed unrealistic prices to protect their business risks due to uncertain scope and requirements. Under-specification might also lead to subsequent disputes during the life of the contract after service transition.

Example 23 – Imprecise service requirements may result in resource mismatches or delivery problems

In general, horticultural workers need to be well versed in specific gardening skills (such as horticultural knowledge, flower-cutting, hand dexterity, planting and propagation). Therefore, they usually get higher pay than cleaning workers in the market. In an outsourcing assignment, however, Department A had not stipulated such requirements in its horticultural maintenance service tender. The skill required from and salaries payable to the contractor's staff were made similar to those of cleaning workers.

As a result, the contractor could not find experienced horticultural workers to take up such roles and had to deploy non-skilled workers to deliver the outsourcing services. The department and the contractor consequently spent a lot of effort in training the non-skilled workers to deliver the horticultural services.

Example 24 – Requesting precise information will facilitate the tender evaluation process

In a property management service tender, the bidders were required to submit the following corporate capability information for tender evaluation:

Information requested	Purpose
1. Tenderer's background information such as a description of the company structure and percentage shareholding, a description of the company management structure, a copy of own assessment of the position of the company within the industry and the data sources used to form that view, number of staff in Hong Kong	Assess the current viability of the tenderers to deliver the service, and their ability to sustain the service throughout the life of the contract
2. Forensic information such as outstanding legal action, litigation, merger, action or disputes	Enable appropriate assessment of risks and capabilities
3. Sub-contracting arrangement	Enable appropriate assessment of risks and capabilities
4. Names and full resumes of the key personnel who are proposed for the contract	Define necessary touch points, roles, responsibilities, resources and capabilities

7.4 Guideline 13: Define Appropriate Terms and Conditions

The User Guide is not intended to provide legal advice. Departments should always work closely with the DoJ and seek its legal advice. Departments should:

- ◆ Plan in advance and define a clear timetable for new or expiring contracts so that the DoJ can plan the allocation of resources accordingly;
- ◆ Seek the DoJ's advice on the legal issues that arise during the tender preparation process;
- ◆ Allow at least 21 working days for the DoJ to review the draft tender document, especially for complex contracts.

7.4.1 Observe the general rules

When drafting tender documents, it is important for departments to observe the following general rules:

- ◆ Know what you want;
- ◆ State clearly the party responsible for performing a contractual obligation (who), when the task should be completed (when) and what the obligation is (what);
- ◆ Think about the worst case scenarios (e.g. failures to meet service levels, contract termination, etc);
- ◆ Plan for the termination/expiry of the contract;
- ◆ Ensure that the provisions are certain and clearly expressed – oral agreements are binding but the court will only enforce an oral agreement if it is satisfied that sufficient evidence is adduced to prove the existence of such agreement and the terms of the agreement. Written agreements should be used and the terms of the agreements need to be clearly drafted;
- ◆ The court will construe any ambiguity in a written agreement against the drafter (in this case the Government);
- ◆ Apply logical thinking and ensure consistency throughout the tender document;
- ◆ Do not rely on implied terms;
- ◆ Start with the service specification;
- ◆ Define contract/project management and monitoring schemes.

7.4.2 Beware of general contract considerations

As departments are drafting tender documents, they often come across several contractual issues. Below are a number of general guidelines on how departments can deal with these issues:

- ◆ **General versus special conditions of contract.** The GLD provides standard contract terms and departments can decide whether to apply these standard terms in their contract or draft their own standalone, self-contained contract that is appropriate to the peculiar procurement. If departments choose to adopt the latter approach, they should be aware that there is no need to separate the contract into “general conditions” and “special conditions”. In a standalone contract, it is unnecessary to make such a distinction;
- ◆ **Conditions versus warranties.** Conditions are fundamental terms that can lead to contract termination if they are breached. A breach of warranty gives rise to a claim for damages but not the right to treat the contract as repudiated. Departments should be aware of the difference between the two when drafting contracts;
- ◆ **Contract price.** Departments should clearly specify what formulae will be used for the calculation of price and payments. For complex calculations, departments should consider describing them in a separate schedule, with precise definitions and examples;

- ◆ **“Public Finance Ordinance”**. If government revenues are involved (e.g. tunnel fees collected by an outsourced tunnel operator), the Public Finance Ordinance (Cap 2) requires that the revenues are received in full by the government. The contractors should not deduct their remuneration from public revenues and then pass the remaining balance back to the government unless they are authorised by statute;
- ◆ **Payment schedule**. The contractor’s remuneration should be paid in arrears after government’s acceptance of the services provided. This will give departments an opportunity to verify whether the contractor’s performance is satisfactory before settling the payment;
- ◆ **“Liquidated damages”**. A provision is enforceable as liquidated damages only if the amount specified in the contract is in its true nature a genuine pre-estimate of loss that a party will suffer as a result of a breach. Liquidated damages are an exhaustive and exclusive remedy for a particular breach. Hence, if the pre-estimated sum is insufficient to compensate the government for the losses suffered by it due to the contractor’s breach of contract, the government cannot claim the shortfall by way of general damages for the same breach. Therefore, departments should assess the pros and cons of employing liquidated damages, examine alternatives (e.g. performance-based bonus as an incentive, demerit points, service credits) and, where necessary, use it with great care;
- ◆ **“Set-off clause”**. An appropriately drafted set-off clause enables the government to deduct from the contractor’s remuneration payable under one contract an amount that is due from the contractor to the government under the same or another contract;
- ◆ **“Time of essence”**. If timing for a particular service is very important and it cannot be delayed at all, departments can consider using a “time of essence” clause. However, departments should be aware that this clause will be applied both ways i.e. departments cannot delay the fulfilment of any of their obligations. There may however be practical difficulties in enforcing this provision. For example the procuring department might be refrained from exercising this right given that the service has reached an advanced stage and it could not afford to ruin the working relationship with the contractor, as this might further delay the completion of the project. Also, departments might be challenged if they were the party who caused the delay;
- ◆ **“Confidentiality clause”**. Departments should be aware of any confidential information that might be passed to the contractors and should put in place an appropriate confidentiality clause in the contract. A confidentiality clause can be very simple or very complex depending on the complexity of the data involved and the severity of the consequences of leakage;
- ◆ **Prevention of bribery**. Departments should build an appropriate prevention of bribery clause into the contract to ensure that contractors will comply with the Prevention of Bribery Ordinance (Cap 201). Departments should also seek advice from the ICAC;
- ◆ **Conflict of interest**. Departments should be aware of any potential conflict of interest, and should include a provision in the contract to deal with it. Departments should again consult ICAC;
- ◆ **Limitation of liabilities**. From a legal perspective, the DoJ does not recommend acceptance of any contractual provision that places limitation on the contractor’s liability beyond the common law principles limiting damages (i.e. causation, remoteness and duty to mitigate). Departments or contractors can propose otherwise but departments must justify the risks that they are willing to bear, given that public money is involved. Nevertheless, departments should note that:
 - Unlimited liability might drive some potential contractors away, as those who have difficulties in seeking approval within their organisations to bid for government contracts would either decline to bid or seek to form an alliance with other potential contractors or become others’ subcontractor;

- There are governments which accept limited liability in outsourcing contracts (e.g. Information Technology (IT) contracts or small scale, less critical service contracts) since they recognise that such a requirement hampers the development of industries and restricts competition (given that very few contractors are willing to accept this requirement).

If departments wish to propose or accept limitations of liability they should seek comment from the DoJ and FSTB and seek approval from the relevant tender boards.

- ◆ **Limitation Ordinance (Cap 347).** If a contract is executed as a deed under seal, an innocent party may take legal proceedings against a defaulting party for a breach of contract within a period of 12 years after the date of the breach. If a contract is executed under hand (i.e. by signing it only), the limitation period for bringing a legal action against the defaulting party is six years from the date of the breach.

Departments should also pay attention to conditions related to the WTO GPA requirements and measures on avoidance of exploitation of non-skilled labour, as described in Chapter 3 and Section 11.5 respectively.

These general guidelines may not be applicable in all cases as each contract is unique. Departments should seek advice from the DoJ on legal issues relating to the contract.

7.5 Guideline 14: Incorporate Provision for Variations

7.5.1 Define change management mechanisms for service scope variations

A typical outsourcing contract will often run for a few years or longer. No matter how well the service requirements are defined in the contract, it is inevitable that some requirements will change over time. Departments should consider including provisions for service scope variation during the contract period.

One way to cater for such service scope variation is to define a change management mechanism in the contract. Departments should clearly specify the processes and criteria on how to amend the service scope as well as the associated fees and expenses. This would help departments avoid suffering from outdated services/technologies or creating disputes with contractors during the life of the contract. Departments should also devise the approach to specify the associated fees and expenses for service scope variations e.g. specify pre-agreed unit rates or pre-agreed units in the contract.

Contracts with too many variation provisions would however lead to a high degree of uncertainty and are often too flexible to be enforceable. Departments should define some broad parameters to limit the room for variation. This can be done by defining a list of service dimensions that can be changed (e.g. frequency of services, servicing hours) under the change management mechanism (see Example 25).

If departments can justify the pros and cons as well as the risks involved, they can consider allowing a single contractor to expand existing services to a broader but defined scope (e.g. delivering services to more districts, taking over part of or the whole of certain districts from other contractors) within the contract period and building the variation provisions into the contract. This may be a useful way to provide a contingency plan in the event that another contractor engaged by the department on similar services is unable to fulfil its obligations.

Departments should anticipate and specify these potential scope variation requirements in the tender document and ensure all bidders will share the same information during the tendering stage. When defining requirements for service variation provisions, departments should consider the following:

- ◆ Brainstorming the possible service changes required in the near and medium term;
- ◆ Evaluating different change management mechanisms for dealing with service scope changes;
- ◆ Assessing if the mechanism is operationally and commercially viable;
- ◆ Building the appropriate mechanism into the tender document (see Example 26), along with the associated terms and conditions.

Example 25 – Define in the tender document the boundaries for service variation

A European government department included the service variation boundaries in its customer service outsourcing contract to define the possible changes upfront and avoid disputes later on. It specified that the following changes were allowed as part of the contract:

- ◆ Requests for the changes to the planned services or contracts in the phasing of the contract;
- ◆ Requests for enhancements to the service specification or contract, which are scheduled to be implemented as planned in the phasing of the contract;
- ◆ Requests for enhancements to those services already being delivered by the contractor;
- ◆ Requests for minor changes;
- ◆ Requests for changes to the incentive mechanism, including the level of incentive available for each performance area;
- ◆ Requests for changes to revise the charges or payment and performance mechanism;
- ◆ Requests for changes to the service performance levels;
- ◆ Requests for processing orders relating to minor changes;
- ◆ Requests for processing orders for the provision of new services;
- ◆ Requests for processing orders to extend existing capacity.

However, departments should ensure that the scope and nature of services should remain unchanged in principle - a service variation provision to cater for a complete change in service nature is not allowed (see Example 27).

7.5.2 Build provisions for continuous improvement

The delivery of continuous service improvement during the contract period is often required in outsourcing contracts due to the fast changing operating environment. Departments should understand the market trends and industry practices in order to assess whether contractors can continue to improve service performance. Departments can build provisions into the contracts such that if the contractor's existing offers are no longer as competitive or attractive as those that are available in the marketplace (e.g. through benchmarking or review mechanisms), they can request the contractors to propose and deploy service improvement solutions (see Example 28).

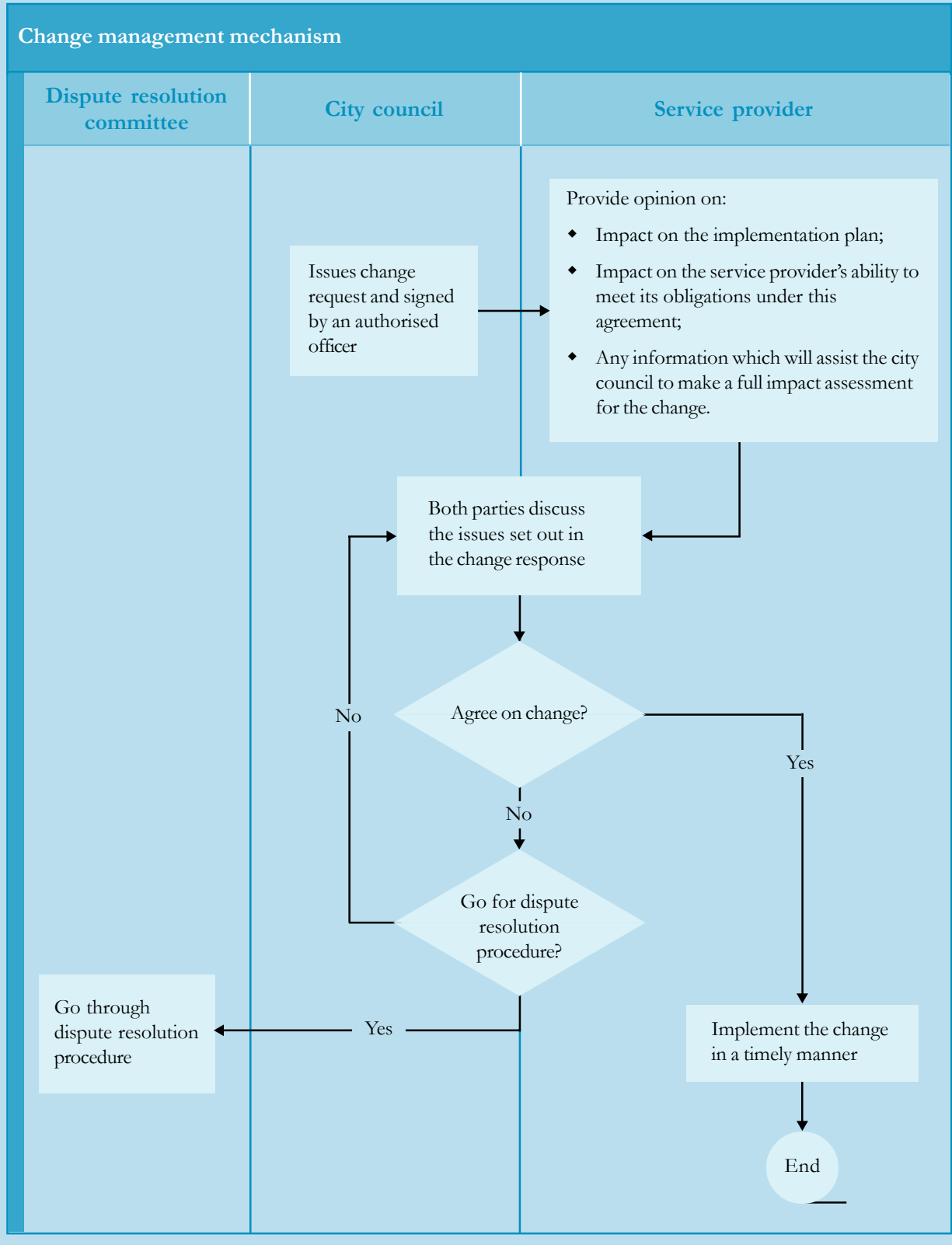
Where appropriate, departments can consider initiating a benchmarking study, which involves gathering information on areas such as price, service levels or any other relevant aspects from the market. The study could be conducted by the department itself (if the benchmarking skills are available in-house) or by an independent party engaged by either the department or the contractor (or as agreed by both parties).

To build appropriate provisions in the contract, departments can consider defining:

- ◆ Periodic review mechanisms (e.g. benchmarking studies, see Example 29);
- ◆ Processes to adjust contract terms (e.g. price, SLA targets) based on the results of the periodic reviews.

Example 26 – A change management mechanism should be defined in the contract

In a customer service contract, a European government department defined its service change management procedures as follows:



Example 27 – Changes of scope are only applicable to similar services

Department A did not define any upfront scope variation provisions in its cleaning service contract. It then attempted to change the scope completely from cleaning services to horticultural services. Since cleaning and horticultural services were two distinct services, the change of scope was rejected by the procuring authorities.

Example 28 – Seek continuous improvement

When Department A outsourced its data centre operations to a contractor, it required the contractor to ensure its service quality and price offers would remain competitive throughout the life of the seven-year contract. On an annual basis, the contractor's performance would be reviewed to see if the contractor had met the Service Level Agreement (SLA) targets and if the SLA targets were in line with market practices. If it was revealed that its service and price performance were not as attractive as the other industry players, the contractor would have to adjust the SLA targets or lower the price to bring them in line with market practice. All these requirements were clearly documented and built into the contract.

Example 29 – Benchmarking requirements should be clearly specified in the contract

In an American non-IT outsourcing service contract, the following benchmarking requirements were specified in the contract and agreed upfront:

“1.01 Benchmarking. Upon the Client's request, upon at least thirty days' notice to the Contractor with a copy to the selected benchmarker, the Client may at any time after the first anniversary of the effective date initiate a benchmark of the services, including rates for projects, in accordance with the terms set forth herein; provided, however, a benchmarking process shall be conducted by the benchmarker no more than once every twelve months during the contract term. The fees and expenses charged by the benchmarker shall be shared equally by both the Client and the Contractor.

1.02 Selection of the benchmarker.

- (1) The client may select the benchmarker to perform the benchmarking process.
- (2) Both parties shall cooperate with the benchmarker, including, as appropriate, making available knowledgeable personnel, and pertinent documents and records.

1.03 Benchmarking Process

.....

1.04 Benchmark Results Review Period and Adjustments. Both parties agree that at no time during the contract term will the fees for the services or projects received by the Client be more than five percent (5%) higher than the average of the normalised benchmark data reflected in the benchmark results. If the final benchmark results issued for any service reveals that the fees to the Client under the contract are more than five percent (5%) higher than the average of the normalised benchmark data reflected in such benchmark results, then the Contractor shall promptly develop and implement a plan and schedule, subject to the approval of the Client, to bring the Contractor to the sample average by closing all benchmarking gaps revealed in the benchmark results (by adjusting fees, service levels or both, in each case as determined by the Client) within ninety days following receipt of the benchmark results.”

8 FORMULATING MARKING SCHEMES THAT EMPHASISE QUALITY OF SERVICE

8.1 Introduction

A marking scheme directly affects the outcome of an outsourcing exercise. It determines whether departments can attract and select the right contractors. Departments should ensure that marking schemes are ready (with appropriate approvals) before they invite tender responses. Departments should also stipulate at least the outline of the marking scheme in the tender documentation. Departments may consider disclosing the technical to price weighting adopted.

This chapter describes the typical challenges related to establishment of marking schemes and advises on how to formulate good ones.

8.2 Typical Challenges Faced by Departments

When formulating marking schemes, departments sometimes fail to set up a stringent evaluation process and define a robust marking scheme, which may result in:

- ◆ Low quality or unqualified bidders ending up having highest overall score (technical plus price);
- ◆ Past performance not being considered or not given adequate weighting;
- ◆ Technical evaluation criteria being structured along a mechanical checklist approach without much clarity about quality and capability.

8.3 Guideline 15: Check Previous Convictions and Demerit Point Records

As one of the first steps in evaluating service tenders that rely heavily on the deployment of a large number of non-skilled workers (but NOT works or other service contracts), departments should check the bidders' previous conviction and Demerit Point System (DPS) records.

For service contracts with tenders invited on or after 1 May 2006, departments should include a mandatory requirement for assessment of bidders' past performance in the terms and conditions of the tender document in respect of compliance with the ordinances and contractual obligations specified in Financial Circular No. 4/2006. If a bidder has obtained any conviction in the specified ordinances **on or after 1 May 2006**, its tender response should not be considered for a period of **five years from the date of conviction**. The conviction record of any participant of a partnership or unincorporated joint venture or shareholder of the incorporated joint venture will also be counted.

The convictions will be counted irrespective of whether they are obtained in respect of a government or private contract, and irrespective of the type of services offered under the contract, and will be counted by the number of summons convicted. Convictions under appeal or review should still be counted until they are quashed by the Courts.

Bidders are required to submit a statement of all convictions or no convictions as part of their tender responses. Departments must specify this requirement in their tender documents. As a transitional measure, during the first

year of implementation, the reference period for which the conviction counts would be the past 12-month period immediately preceding the tender closing date. The reference period will be extended as set out in the Financial Circular.

For service contracts with tenders invited on or after 1 May 2006, if the bidder concerned has, over a rolling period of 36 months immediately preceding the month of the tender closing date, accumulated three demerit points obtained on or after 1 May 2006 from one or more departments, the tender response should not be considered for a period of **five years from the date the third demerit point** was obtained.

Demerit points under appeal should still be counted until they are overruled by a department's appeal panel. As a transitional measure, the reference period for which demerit points count during the first year of implementation should be the 12-month period immediately preceding the month of the tender closing date. The reference period will be extended as set out in the Financial Circular.

Convictions and demerit points obtained after the tender closing date and before the letter of acceptance of the offer is issued should also be taken into account. Departments should review the bidders' convictions and DPS track records as part of the tender evaluation process. Prior to contract signature, departments should verify the latest convictions and DPS track records up to the date of issue of the conditional letter of acceptance.

In addition, if the monthly wages offered by bidders and their subcontractors to the non-skilled workers employed or to be employed for carrying out the contract services are less than the average monthly wages for the relevant industry/occupation as published in the Census and Statistics Department's Quarterly Report of Wage and Payroll Statistics at the time when tender responses are invited, those tender responses should also not be considered further.

The checking of a contractor's conviction record and demerit points is also applicable to sub-contractors where subcontracting and contract extension are permitted. Departments should verify the track records of the contractors and their subcontractors before contract award or renewal or contract extension.

8.4 Guideline 16: Define Appropriate Mandatory/Essential Requirements

Apart from checking conviction and DPS records, departments should consider imposing a set of mandatory/essential requirements and having them clearly specified in the tender document. Such mandatory/essential requirements shall not be waived and the tender document should state clearly that non-compliance with such requirements shall render the tender invalid. The effect of the failure to comply with a mandatory/essential requirement should be **expressly** stated and explained i.e. "failure to meet this requirement renders the bid non-conforming and it will not be considered further".

The mandatory/essential requirements may include items such as professional qualifications or certification, experience with other similar projects, past performance, capacity, facilities or locations (as long as they are aligned with the relevant regulatory framework requirements as set out in Chapter 2). The mandatory/essential requirements should only represent those that are absolutely necessary and critical.

Key positions (e.g. managers or supervisors) could be defined in the tender document. Where applicable, for services which involve the handling of confidential or personal information, departments could also perform vetting on persons (e.g. on whether they have any criminal records) who are proposed by potential contractors to take up key positions in the outsourcing services prior to contract award.

Before conducting a full technical evaluation, departments should conduct compliance checking against the mandatory/essential requirements. Any tender responses not complying with the mandatory/essential requirements should not be considered further. Thus departments can streamline the evaluation process by focusing only on qualified bids.

8.5 Guideline 17: Define the Criteria and Weighting for Technical and Price Evaluation

For detailed evaluation, departments should have a marking scheme that maintains an appropriate balance between technical and price evaluations. Based on previous tendering experiences as well as the nature and complexity of the services to be outsourced, departments should give sufficient weighting to technical quality to avoid the price factor being too dominant.

Nevertheless, to serve the best interests of the Government, it is important to balance percentages of technical and price – too much weight on price may be at the expense of technical abilities, issues of judgment, professionalism and artistic quality which are important considerations for certain tenders. It may be appropriate to give more weight on price for tenders involving the provision of services that have become commoditised. Procuring departments will have to maintain a right balance depending on the nature of the tenders.

Since the use of a marking scheme invariably involves a technical evaluation conducted separately from the price evaluation, a ‘two-envelope’ approach towards technical and price evaluation should be adopted. The price envelope should be opened for price evaluation only after the completion of the technical evaluation and only the bidders that have passed the technical evaluation will be considered further.

In addition to balancing the weighting between technical and price evaluation, departments can, within the technical evaluation category, define sub-categories of criteria to assess different technical aspects of the tender responses (see Examples 30 and 31).

Example 30 – The relative weight of the technical and price evaluations will vary depending on the nature of the services

In an IT service contract for an American firm, the cost of the services carried 25% of the total score while the remaining 75% came from technical evaluation as the firm’s main focus was to have a good technical solution and quality services. The full set of evaluation criteria is summarised below:

Category	Relative weight	Sub-category	Relative weight for sub-category
Price	25%	Retained cost	10%
		Price	50%
		Transition cost	10%
		Break even point	5%
		Transparency	5%
		Pricing variable	10%
		Optional/alternative pricing	5%
		Termination cost	5%
Technical	75%	Service	20%
		Compliance to RFP requirements	20%
		Technical skills and breadth	13.5%
		Transition plan	13.5%
		Experience with the required technology	13.5%
		Business recovery competence	13.5%
		Customer satisfaction	6%

Example 31 – The key technical evaluation criteria should be defined along with their relative weightings

A global oil and petrochemical company defined a marking scheme for its IT service tender. Under the technical evaluation category, five sub-categories were defined as shown below:

	Categories of evaluation criteria and their descriptions		Relative weightings
1	Business considerations	Analysis of benefits that the contract fits to the company's business objectives, financial stability and the contractor's track records	19%
2	Technical expertise	Skill level of the contractor for configuration and demonstrable understanding of technical requirements	24%
3	Service provision	Understanding and management of the security risk, suitability of approach and methods	19%
4	Transition	Structured approach to transition, achievability, realistic timescales, clear cut-over point, current staff definitely released from their duties	24%
5	Staffing /policy	Control and communications mechanisms, clarity and appropriateness of proposed contractor's organisation	14%
		Total weighting (within technical evaluation)	100%

To safeguard the quality of the services to be outsourced, it is often useful to set a minimum pass mark for technical evaluation. The purpose of setting a minimum pass mark for technical evaluation is to screen out bids with relatively low quality technical proposals. The pass mark can be set up for the entire technical evaluation category, for all or specific sub-categories or for an individual requirement. If a pass mark is set up for an individual requirement, departments should review whether there is a need to classify it as a mandatory requirement.

Any of these specific pass mark requirements should be clearly specified with justifications in the tender document, so that all bidders will have a clear understanding of the evaluation criteria and propose appropriate solutions accordingly.

In addition, bidders' past performance with government and/or private sectors should be considered as part of the technical evaluation. Provided that other potential contractors will not be put into an unfair position, sufficient weighting on past performance should be given which will help incentivise the contractors to perform well in existing contracts (see Example 32).

To encourage employment of persons with disabilities, tenderers may be awarded bonus scores in the technical evaluation if they offer to employ them.

In addition to comparing the proposed prices among bidders, departments should always perform a cost-benefit analysis and consider the funding arrangements. When departments estimate the full costs of in-house services, they should be aware of any hidden costs for services that are provided by other departments but have not been charged to them.

FORMULATING MARKING SCHEMES THAT EMPHASISE QUALITY OF SERVICE

Departments should review the overall evaluation results and assess if the top scoring bidder can deliver the committed services within the quoted price. Departments may discard the top scoring bidder(s) or bids with the lowest prices if their price offers were unreasonably low (e.g. by comparing the market prices and/or previous bidding price). Before doing so, the relevant department must have made enquiries with the bidder submitting the unreasonably low bid and from such enquiries the relevant department is not satisfied that the bidder:

- (1) Can comply with the conditions for participating in the relevant tender exercise; or
- (2) Is capable of performing the contract, having regard to the unreasonably low price bid.

The department should also consult the relevant tender board and, where legal issues are involved, the DoJ.

Departments should also expressly provide in the tender documentation that the Government may not award a contract to a tenderer whose tender price is found to be unreasonably low or the tenderer is commercially, financially or technically incapable of undertaking the contract.

For possible future examination or enquiry by unsuccessful tenderers, departments should keep a proper detailed record of the reasons for rejecting a bid.

Example 32 – Bidder’s past performance should be part of the technical evaluation

In a property management service contract, Department A defined six key evaluation categories for technical evaluation, in which the tenderer’s past performance would account for 14% of the total technical score as shown below:

	Categories of evaluation criteria	Relative weightings
1	Corporate capability	15%
2	Service delivery	38%
3	Tenderer's experience	20%
4	Tenderer’s past performance records	14%
5	Helpdesk	8%
6	Transition and implementation	5%
Total for technical evaluation		100%

8.6 Guideline 18: Make Evidence-based Judgements on Quality Rather Than Relying on a ‘Checklist Approach’

During tender evaluation, departments should assess the tender responses based on the substance and quality of the information provided, rather than the mere existence of the information. A checklist can be used to verify if the information required for tender evaluation has all been submitted or not, but it should not be used as an evaluation tool (see Example 33).

Departments should define a comprehensive marking scheme, which has to be approved for use before tender opening, to score the level of quality and capability using a given rating scale (say from 0 to 5) (see Example 34).

Example 33 – The checklist approach provides insufficient information about the level of quality or capability

Department A used to adopt the checklist approach for tender evaluation. Over time, it realised that such an approach could provide an indication of “yes, they have it” or “no, they do not have it”, but did not help the department differentiate the level of quality and capabilities amongst bidders. This approach proved to be ineffective, and Department A found it difficult to make an objective assessment and fair comparison of the tender responses simply based on yes-no answers.

Example 34 – Defining the rating scale will help ensure an objective, fair technical evaluation

When a European government department evaluated the tender responses for a customer service outsourcing contract, the evaluation team defined a comprehensive marking scheme with a detailed rating scale for each evaluation item to ensure an objective evaluation of tender responses. An example of the rating scales extracted from the marking scheme is shown below:

Item under evaluation	Rating Scale	Description of the rating scale
Experience of core team members	1	Poor technical experience and professional qualifications
	2	Limited experience
	3	2-4 years relevant experience
	4	Certified Project Manager or equivalent, and have 5-10 years relevant experience
	5	Certified Project Manager or equivalent, and over 10 years experience of managing similar projects

Departments should also request that bidders submit relevant evidence that demonstrates their capabilities for evaluation (see Example 35). Departments should assess the evidence and make a professional judgement on an appropriate score based on the pre-defined rating scale.

Example 35 – Departments may check the relevant evidence if necessary

When a European government department scored the tender responses, it requested the bidders to submit relevant evidence and information for their assessment. Some examples are extracted below:

Items under evaluation	Sources of evidence/ information to look for in the tender responses
Financial stability	Audited financial statements of the bidder for the last three to five years; Proof of current financial status issued by the bidder’s banker; Parent company’s guarantee, if required.
Experience of core team members	Curriculum Vitae of each member; Copies of the transcripts, education certificates, professional qualification/ membership documentation; Testimonials from customers, previous employers.

In addition, departments should also make the best use of bidders' presentation sessions (if they are held) as an opportunity to clarify any queries in relation to the bidders' written proposals (but not to seek extra information about the quality of the bidders or their offers). Care must be exercised by departments to ensure the integrity and transparency of the tender evaluation process and to avoid unfair or biased scoring in favour of some bidders over others.

8.7 Guideline 19: Conduct Appropriate Levels of Due Diligence

After identifying a top scoring (combined technical and price scores) bidder, due diligence on the top scoring bidder should be performed before any decision is made. The objective of the due diligence exercise is to verify whether the tender responses and capability claimed by the preferred bidder are well-grounded. This can be done prior to contract award or if negotiation is required, prior to or in parallel with contract negotiation. Where necessary and practical, departments can perform due diligence on a few of the top scoring bidders as part of the technical evaluation.

Depending on the nature and significance of the outsourcing exercise, departments will need to exercise their professional judgement to determine the level of detail and the extent of the due diligence activities required. This can often be conducted through cross-referencing, face-to-face meetings or interviews with the bidders' existing or previous customers, document examination and/or site visits. The due diligence activities should be stipulated in the tender documentation. The Tender Assessment Panel has overall ownership of the due diligence exercise.

Conducting due diligence can help departments to validate:

- ◆ The credentials of the preferred bidder and its key staff;
- ◆ The financial position of the preferred bidder;
- ◆ The physical or intellectual property assets committed by the preferred bidder for the delivery of the service;
- ◆ The preferred bidder's procedures on ethical business practices and non-disclosure of confidential information;
- ◆ Any potential conflicts of interest.

As a full-scale due diligence exercise can require substantial effort, departments should determine the appropriate level of detail that will represent a good balance between the level of confidence required and the effort involved in the due diligence process.

The nature and coverage of due diligence will vary according to the nature and scope of the outsourcing deal. Where appropriate, departments may seek advice or specialist expertise from external consultants to assist in the due diligence process. As described in Section 5.4, departments should be aware of any consultants' possible conflict of interest in the procurement process and consider prohibiting the engaged consultant from participating in any related tendering exercise.

Departments should also stipulate provisions in the tender documentation to address the scenario when the recommended bidder is found financially incapable of undertaking the contract, e.g. whether an additional performance bond will be required to be submitted to safeguard the Government's interest or the proposal will not be considered at all.

9 EFFECTIVE PERFORMANCE MANAGEMENT

9.1 Introduction

Performance management is a very important aspect of contract management. Among the biggest challenges for departments are to define performance measures and targets prior to the tendering stage or to monitor the contractors' performance during contract execution.

This chapter describes the typical challenges faced by departments in performance management and provides advice on how to address these challenges.

9.2 Typical Challenges Faced by Departments

There are a number of common poor practices in relation to performance management during contract preparation and execution:

- ◆ Having too many irrelevant performance measures and reports, resulting in unnecessarily high administrative effort for both contractors and departments and a significantly long lead time in confirming service delivery and authorising payment;
- ◆ Defining impractical measures, requiring unreasonably huge effort to measure and report performance, which can be expensive and complex in execution;
- ◆ Insufficient communication and exchange of views at the senior management level from both parties;
- ◆ Adopting adversarial monitoring approaches;
- ◆ Micromanagement of contractors resulting in unnecessary interference and government taking back risks that the contractor is being paid to bear.

The key challenges are how to define practical service performance measures and targets, as well as the associated performance management process.

9.3 Guideline 20: Define a Reasonable and Achievable SLA

The purpose of the SLA is to provide a clear basis for determining the acceptable level of the contractor's performance and hence payment approval. The following sections describe how to define a SLA in more detail.

9.3.1 Define only a manageable and practical set of service performance measures

Departments should define a set of practical and manageable performance measures in the SLA. The measures should support the objectives of the outsourcing exercise, address key service requirements and be aligned with the performance pledge that departments have committed to their customers internally and externally – i.e. staff and the general public (see Example 36).

However, not all aspects of the outsourced services need to be monitored. Departments should consider applying the 80/20 rule to identify an appropriate, manageable number of performance measures and focus on the most critical and representative measures (see Examples 37 and 38).

Example 36 – An SLA should align with the performance pledge to customers

One of the key services in a government department's data centre contract was the handling of incoming customer enquiries by the help desk. Key performance measures that were critical to the help desk service were defined and the performance targets were aligned with the performance pledge that the department had committed to its customer departments (i.e. internal SLAs). Some of the service performance measures and targets for the contractor from the SLA are shown below:

Measures	Requirement	Service performance targets
Call pick-up rate	Answering incoming calls within <= 15 seconds <= 20 seconds <= 25 seconds	>= 85% >= 95% >= 98%
Call abandonment rate	Daily rate = All telephone calls abandoned by users within the first three seconds, divided by the total calls made to the help desk.	<= 2%

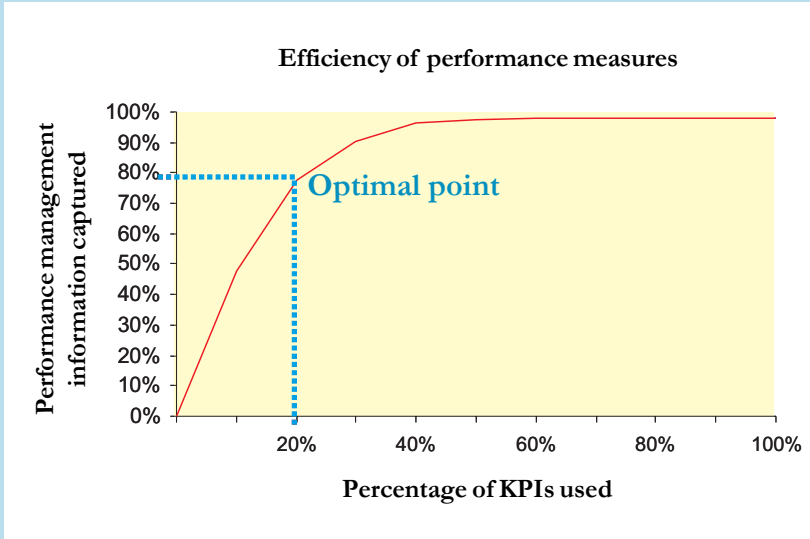
Example 37 – Too many performance measures may distract management focus from the performance of key areas

Department A had defined 13 service areas in a property management service tender with over 100 service requirements. Within each service area, a long list of requirements was specified. The attempt to measure performance of each service requirement ended in failure - as it is impractical to measure performance for each requirement. The contractor had to spend excessive time and resources on performance reporting. The department had to identify the real performance issues buried in a large number of reports submitted by the contractor. Some examples of non-critical or non-measurable requirements from the tender are shown below:

Examples of non-critical items	Examples of non-measurable items
<ul style="list-style-type: none"> ◆ Input of acceptance/refusal of offers within two working days ◆ Random viewing of security video tapes by security supervisors within 48 hours of recording ◆ Comply with promotional activities 	<ul style="list-style-type: none"> ◆ Inspection of decoration and follow up with the appropriate inspection constructor ◆ Contact elderly residents within an hour when the temperature drops to 12°C.

Example 38 – The 80/20 rule helps identify critical performance management measures

The number of performance measures to be specified in the SLA will vary depending on the nature and complexity of the outsourced services. A rule of thumb is to focus on key measures that will give a good view of the key performance areas, and this can be done by applying the 80/20 rule as illustrated in the diagram.



Having too few measures will provide insufficient information for departments to review how well the contractor has performed. Conversely, defining all measures to get a full view of all service performance is also undesirable as the contractor should spend time focusing on delivering quality services rather than preparing lots of performance reports.

The operations department of a global insurance company in India applied the 80/20 rule when it defined service performance measures and targets. While it operated all transaction processes and a customer relations function covering over 50 services, it categorised all activities into four main streams and designed measures for critical and representative items in each stream. These are shown below:

Type of service to be managed	Metrics	Target
Transaction processing	<ul style="list-style-type: none"> Percentage processing done on time (against agreed service levels) Accuracy of processing (measured as percent cases processed correctly) Number of cases processed per day (volume/day) 	<p>95%</p> <p>90%</p> <p>2000</p>
Inbound customer contact	<ul style="list-style-type: none"> Average handle time (minutes) Abandonment rate Percentage calls answered within agreed SLA (or average speed of answer) First time resolution percentage Number of calls handled per day 	<p>2</p> <p>5%</p> <p>95%</p> <p>75%</p> <p>1000</p>
Outbound customer contact	<ul style="list-style-type: none"> Calls completed per hour Sales made per hour Conversion rate 	<p>15</p> <p>3</p> <p>20%</p>
Transition performance	<ul style="list-style-type: none"> Time to reach baseline performance Time to clear back log of transactions 	<p>3 months</p> <p>4 months</p>

9.3.2 Make best use of historical data analysis or benchmarking studies

Sometimes, especially for services that have not been outsourced by a department before, it is difficult to determine performance targets. In such cases, analysis of historical data will often give a good idea of the likely performance targets that contractors should and could deliver. As illustrated in Example 39, internal data analysis can be done through:

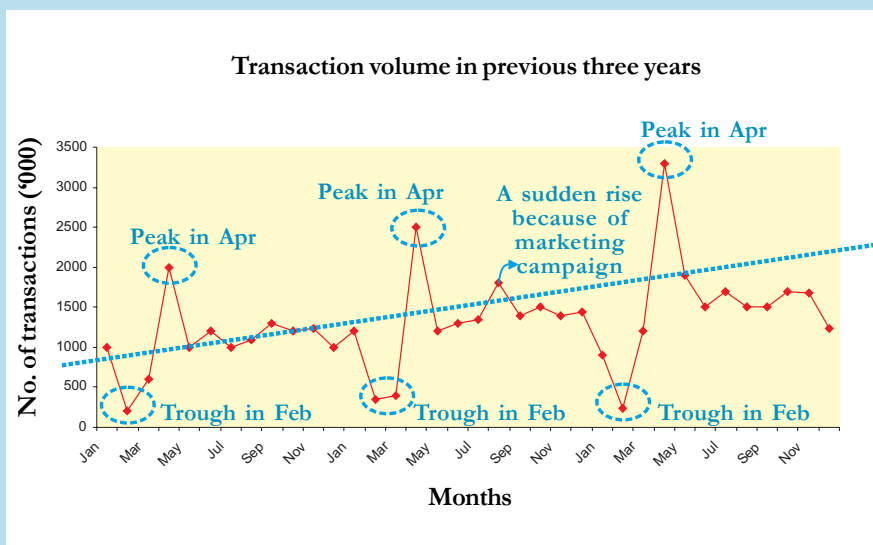
- ◆ Gathering performance, volume and other data of the relevant services for the last few years;
- ◆ Analysing the general performance, volume levels and their trends;
- ◆ Identifying any periodic and seasonal trends.

To supplement the internal data analysis, departments can review information from market practices and external benchmarking studies for similar services in other public or private sectors when relevant data is available, or by commissioning new studies where necessary (see Example 40).

Very often, a wealth of useful data already exists somewhere in the department. It is just a matter of unlocking the valuable information embedded in the raw data. Departments are encouraged to review whether the data can help them understand the issues, trends or performance.

Example 39 – Performance targets can be set by analysing data on the historical trends

A financial institution intended to define the number of customer service counter transactions processed as one of the throughput performance measures. To define the performance targets, it analysed its historical data to understand the number of transactions currently being processed prior to outsourcing, identifying the averages, variances, peaks, troughs and other seasonal trends, as illustrated in the graph below.



Generally speaking, there is an upward trend, with a steady annual increase in transactions processed, with seasonal trends in April (peak) and Feb (trough).

Irregularities would be excluded from consideration when determining the performance targets

Example 40 – Performance targets may take account of the historical trends and market best practice

A global oil and petrochemical company outsourced an IT system service to a contractor, where the incident management process was one of the key services. In addition to conducting data analysis to examine the historical service performance, the company studied the performance targets for similar services delivered by industry players in the market. Performance targets were defined using a hybrid approach – taking into account what had been done internally and best practice targets achieved by the contractors.

Measures	Definition	Severity of the incidents	Service target for each level of severity
Incident response	Time taken to confirm acknowledgement of incident	1	Within 1 hour 80% of the time Within 2 hours 100% of the time 24x7 support offered
		2	Within 2 hours 80% of the time Within 4 hours 100% of the time Local business hours - best efforts
		3	Within 4 hours 80% of the time Within 8 hours 100% of the time
		4	Within 24hrs 40% of the time Within 40hrs 100% of the time
Incident resolve	Time taken to resolve incident	1	Within 2 hours 80% of the time Within 4 hours 100% of the time 24x7 support offered
		2	Within 4 hours 80% of the time Within 8 hours 100% of the time Local business hours - best efforts
		3	Within 16 hours 80% of the time Within 32 hours 100% of the time
		4	Within 32 hours 80% of the time Within 64 hours 100% of the time

9.3.3 Focus on output-based service performance measures

Service performance measures should be defined to measure service outputs rather than inputs, allowing departments to have a more accurate and realistic view of the contractor's performance.

However, it is difficult to define output-based performance measures when the service requirements are input-based. Input-based measures tend not to provide information on the quality of service. Output-based measures could more easily be generated from output-based service specifications. Examples 41 to 42 offer illustrative examples.

Example 41 – Examples of input and output performance measures

According to guidelines published by the United Kingdom Government for managing the contractor relationship, performance measures should focus on measuring outputs. The following examples illustrate the difference between input-based and output-based performance measures:

Input-based measures	Output-based measures
<ul style="list-style-type: none"> ◆ Number of catering staff on duty ◆ Amount and quality of raw ingredients 	<ul style="list-style-type: none"> ◆ Number of meals provided ◆ Range of menu options ◆ Satisfaction of diners
<ul style="list-style-type: none"> ◆ Number of cleaners ◆ Type and brand of cleaning materials 	<ul style="list-style-type: none"> ◆ Area cleaned ◆ Satisfaction of occupants ◆ Cleanliness of buildings ◆ Compliance with regulations relevant to cleaning materials
<ul style="list-style-type: none"> ◆ Number of maintenance engineers available 	<ul style="list-style-type: none"> ◆ Percentage of calls responded to and resolved within 30 minutes
<ul style="list-style-type: none"> ◆ Number of instructors required to conduct X number of courses 	<ul style="list-style-type: none"> ◆ Percentage of trainees trained who reached the standard required

Example 42 – Output-based service specifications facilitate the development of output-focused performance measures

Departments A and B outsourced their car park security services. They developed the service requirements and performance measures using different approaches as shown below:

Input-based approach - Department A	Output-based approach - Department B
<p>Service requirement:</p> <ul style="list-style-type: none"> ◆ At least two security guards provided at the counter of each domestic block, one is responsible for checking the identity of entering vehicles and the other one for monitoring vehicles leaving the car park. 	<p>Service requirement:</p> <ul style="list-style-type: none"> ◆ No unauthorised access 24 hours per day, 365 days per year.
<p>Corresponding SLA measure:</p> <ul style="list-style-type: none"> ◆ Number of security guards per shift. 	<p>Corresponding SLA measure:</p> <ul style="list-style-type: none"> ◆ 99% compliance.

9.4 Guideline 21: Establish Effective Performance Monitoring Mechanisms

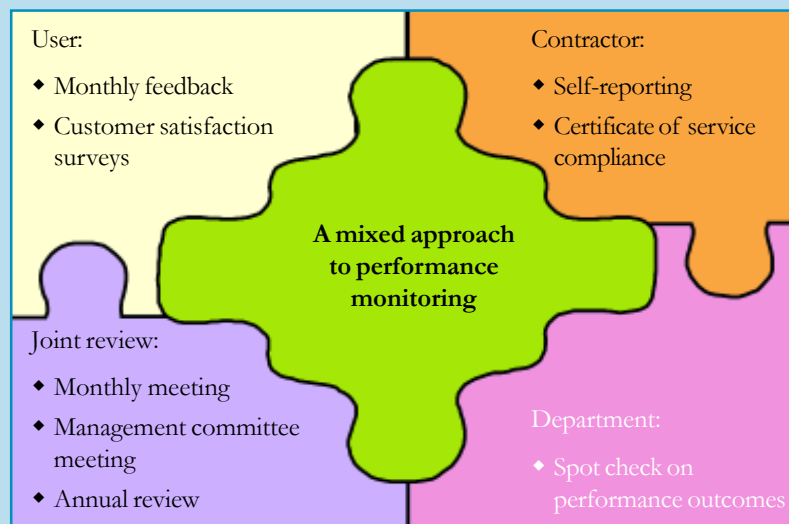
9.4.1 Evaluate the performance via a mix of methods

It is essential for departments to establish an effective performance monitoring mechanism. In addition to defining the performance measures and targets, departments should determine the method and frequency of monitoring. Departments themselves taking performance measurements is only one of the methods in gathering performance data. Other common methods include self-reporting and self-declaration of compliance by contractors, end user satisfaction surveys, spot checks, ad-hoc site audits, external audits, etc. Various methods can be considered for adoption in different situations, and a combination of several methods will further ensure an objective assessment of contractors' performance (see Example 43 and 44).

Not all service performance will need to be measured frequently. For less critical measures or those measures which are self-reported by the contractors, departments should consider adopting a "spot check" approach and gathering performance data only upon complaints or other exceptional events that may indicate a performance issue.

Example 43 – A mixed performance monitoring approach

In a property management services contract, Department A adopted a mixed approach for performance monitoring, involving different stakeholders in different stages of the monitoring process (see the diagram below).



This combination of performance monitoring mechanisms enhanced the process transparency and facilitated communication and continuous service improvement.

Example 44 – Performance monitoring for a data centre outsourcing contract

In a data centre outsourcing contract, the following performance monitoring mechanisms were adopted to manage and review the contractor's performance:

- ◆ Monthly self-reporting by the contractor;
- ◆ Half-yearly end user satisfaction surveys;
- ◆ Ad-hoc and annual audits for pricing review;
- ◆ Annual external independent audits;
- ◆ Annual performance review.

When drafting the terms and conditions of contracts, departments should include provisions for performance monitoring mechanisms (e.g. inspection rights, access to records, right to conduct audit checks) and impose administrative sanctions. It is also beneficial to ask contractors to put in place appropriate complaints/feedback logging and handling mechanisms, and to submit quality assurance plans and complaint handling procedures as part of their tender submissions.

In addition, to detect exploitation of labour, departments should consider monitoring measures for compliance against employment-related contractual requirements and wages. This can be done by, for example, reviewing the number of complaints and suspected labour exploitation cases referred by the trade unions and the Labour Department.

9.4.2 Ensure that the right stakeholders look at the right measures

Departments should set up a multi-tier governance structure to facilitate communications among headquarters, districts and contractors at the management and working levels (see Guideline 22). Different stakeholders have different roles to play in managing the relationship with contractors. As they focus on diverse aspects of the outsourced services, different performance reports will be required to satisfy their information needs (see Example 45).

Example 45 – Different stakeholders focus on different performance measures and have different information needs

A two-tier governance structure was established to manage a government department’s data centre outsourcing contract. Given the different roles and responsibilities of the stakeholder groups, the stakeholders focused on different performance measures and hence different sets of performance reports. Some of the service reporting requirements were:

Reporting audience	Reporting frequency	Reports
Steering group	Every six to twelve months	<p>Management reports including:</p> <ul style="list-style-type: none"> ◆ Satisfaction survey reports; ◆ Results of any annual reviews (including operational and security audits); ◆ Results of any benchmarking studies; ◆ Reviews of the threshold workload and peak workload, and achievement of service performance targets; ◆ Reviews of the charges payable to the contractor, as compared with the contractor’s other customers; ◆ Security matters; ◆ Operational risks identified by either party; ◆ The contractor’s overall performance achieved against the service performance targets and the overall agreement, and any other performance related matters.
Service review group	Monthly	<p>Performance reports showing:</p> <ul style="list-style-type: none"> ◆ Service performance levels actually achieved against service performance targets; ◆ Details of any service level defaults; ◆ Trends in performance against service performance targets and any actions arising; ◆ Trends in services usage; ◆ Contractor recommendations for revisions to performance; ◆ Specific problems/risks and progress on resolution/mitigation of the same; ◆ Summary of progress and status of all operational changes.
		<p>Periodic service performance level reports consisting of:</p> <ul style="list-style-type: none"> ◆ Service performance levels achieved against the service performance targets by category; ◆ Performance trend reports including trend analysis of the service performances by category and breakdown analysis of in-scope systems downtime by components of the technical infrastructure; ◆ Trend analysis of the components in default by, at least one month, rolling three months and rolling 12 months; ◆ Response times to requests for assistance.
		<p>Periodic help desk and fault statistics reports consisting of:</p> <ul style="list-style-type: none"> ◆ Fault statistics; ◆ The percentage of faults resolved within the service performance targets; ◆ The average time to resolve the faults by fault severity level.

10 MANAGING CONTRACTOR RELATIONSHIPS

10.1 Introduction

Successful outsourcing requires both parties to act ethically and collaborate closely with each other if they are to develop trust and a good relationship³. It is beneficial for departments to adopt a partnership mentality when managing the contractor relationship. It is an art rather than a science to manage a ‘win-win’ department-contractor relationship.

This chapter describes the typical issues involved in contractor relationship management and provides advice on how to tackle them.

10.2 Typical Challenges Faced by Departments

When managing contractor relationships in an outsourcing arrangement, departments should adopt an effective monitoring approach and take measures to ensure contractual obligations are met. Taking an adversarial and micro-management approach may lead to unnecessary tensions between departments and contractors.

Managing a successful outsourcing relationship will require the adoption of a partnering approach with the contractors. How to facilitate open communication, build mutual trust and gain commitment between both parties are major challenges for departments. To achieve successful partnering, departments need to focus on:

- ◆ Shared objectives;
- ◆ Best value for money;
- ◆ A long-term relationship;
- ◆ Mutual trust/cooperation;
- ◆ Measuring output performance;
- ◆ Mutually agreed requirements;
- ◆ Early integrated planning;
- ◆ Open joint communication.

10.3 Guideline 22: Ensure Appropriate Governance Structures and Processes

To maintain a good relationship between departments and contractors, it is important to have a multi-tier governance structure. A best practice governance structure will have the following characteristics:

- ◆ Stakeholders are engaged at all levels from relevant parties (e.g. senior management, contract managers, operating staff) with clear roles, responsibilities and counterparts identified;
- ◆ A single contact point (e.g. contract managers) from both parties is available to ensure unity of responsibilities and consistency of information exchange;
- ◆ Headquarters and district/local operations are suitably involved.

Depending on the scope and complexity of the outsourcing contracts, the governance structure may vary from

³ It is worth recalling the words of US President Ronald Reagan when asked whether he trusted the Soviet Union to abide by its commitments to reduce its nuclear arsenal. “We trust, but verify,” he said.

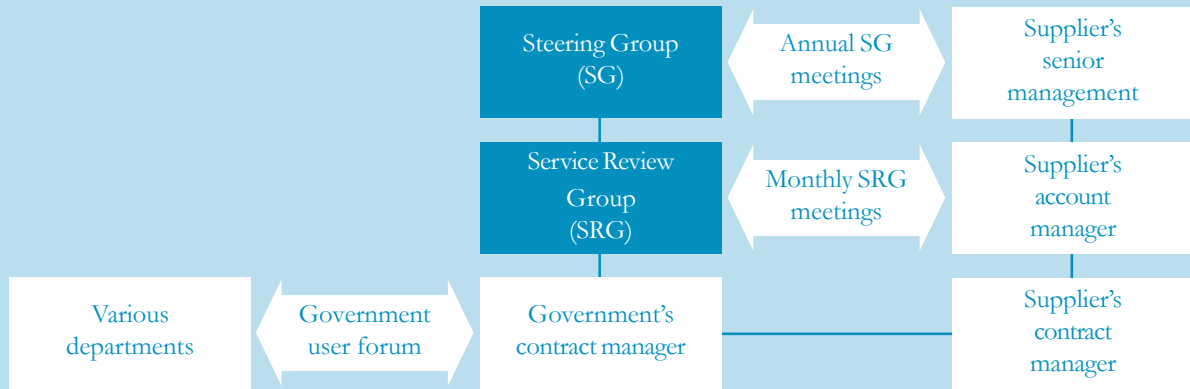
contract to contract. Examples 46-48 show different governance structures.

Having an appropriate governance structure itself would not guarantee a successful outsourcing partnership. Departments should also have associated management processes in place, such as:

- ◆ Holding regular meetings with the steering group and senior management to steer strategic directions and address major issues;
- ◆ Meeting regularly with service review groups or user groups to solicit feedback and understand the evolving operating environments;
- ◆ Managing issues and risks;
- ◆ Performing major contract reviews;
- ◆ Invoking feedback and continuous improvement mechanisms.

Example 46 – Governance structure for a data centre outsourcing contract for various customer departments

In a data centre outsourcing project for Department A, a two-tier governance structure involving representatives from Department A, its user departments within the government and the contractor was set up to govern both the strategic and operational aspects of the contract. The governance structure used and the composition, roles and responsibilities of the relevant parties are summarised as follows:



	Composition	Roles and responsibilities
Steering group	<ul style="list-style-type: none"> ◆ A senior management representative from the government (Chair) ◆ Government's contract manager ◆ Senior management executive from the contractor ◆ Contractor's account manager ◆ Contractor's contract manager ◆ Temporary stakeholders as appropriate and nominated by either party and agreed in advance by the other party ◆ Other temporary individuals relevant to particular issues, as nominated by either party and agreed in advance by the other party 	<ul style="list-style-type: none"> ◆ Provides the overall framework and strategic directions for the contract ◆ Ensures objectives of the contract are achieved ◆ Helps the contractor understand the government's business plans, future objectives and business improvement strategies in relation to the services ◆ Ensures proposed improvement to the government's business can be designed and implemented so as to improve services quality and maximise the value to the government ◆ Ensures that the scope and nature of the contract remains relevant to the government's evolving needs
Service review group	<ul style="list-style-type: none"> ◆ Government's contract manager (Chair) ◆ Government's programme manager ◆ Government's security manager ◆ Contractor's contract manager ◆ Contractor's data centre manager ◆ Contractor's security manager ◆ Temporary stakeholders as appropriate and nominated by either party and agreed in advance by the other party 	<ul style="list-style-type: none"> ◆ Oversees the operations of the outsourced services, change approval process, commercial matters relating to payments for the services and any proposed changes to the contract

Example 47 – Governance structure for a complex large-scale outsourcing contract

In a European government department’s customer service contract, a wide range of services was outsourced. Due to the complexity and scale of the contract, a three-tier governance structure was established and each level had its roles and responsibilities clearly defined as follows:

	Composition	Roles and responsibilities
Board level	Senior board level staff from the contractor and the government	<ul style="list-style-type: none"> ◆ Review and assess the success of the contract and the relationship between both parties ◆ Undertake periodic reviews of the contract and associated performance ◆ Seek to resolve unresolved disputes escalated to it in accordance with dispute resolution procedures
Intermediate level	Senior management of the service contractor and the government, reporting to the board level	<ul style="list-style-type: none"> ◆ Review the operation of the contract, identify risks and issues arising, commission work to address these, ensure that such work is completed in a timely fashion and to adequate standards ◆ Seek to resolve such unresolved disputes ◆ Ensure that senior managers on both sides have a complete and accurate understanding of the contract and its operation ◆ Evaluate each party's skills and resource requirements in relation to the delivery of the service requirements
Service management	Management staff from both parties, reporting to the intermediate level	<ul style="list-style-type: none"> ◆ Monitor and review service delivery and assurance, customer relationship and satisfaction, the operation of contractual procedures and quality management ◆ Oversee meetings between the parties’ respective management teams including, but not limited to, continuous service improvement, service management, security management and business continuity ◆ Resolve such disputes as may have arisen between the parties, or escalate them to the Intermediate Level when achievement of resolution is found to be impossible within a reasonable time

Example 48 – Governance structure for a leisure facility management services contract

When Department A outsourced its regional leisure facility management services, a two-tier governance structure was set up to manage the contract:

- ◆ A joint management team was formed with representatives from the headquarters, district venue managers and the contractor. Regular meetings were arranged to review performance issues and contractual issues. Venue managers were encouraged to provide feedback, good and bad, directly to senior management of contractors;
- ◆ A joint working group was also set up to handle operational issues on a daily basis.

This open and clear communication at senior and working levels enhanced communication and understanding of mutual expectations.

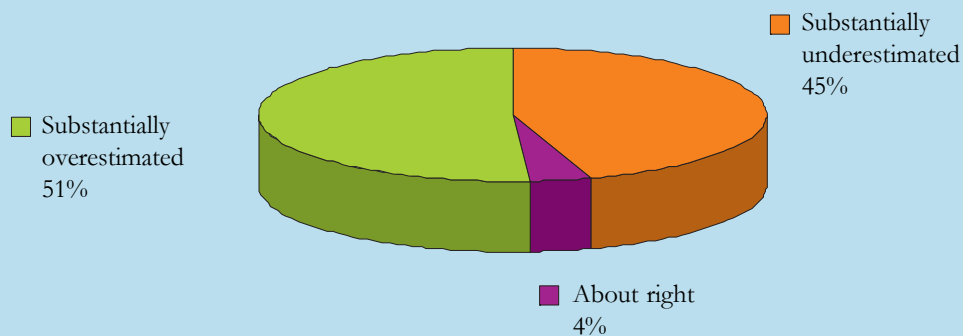
10.4 Guideline 23: Build a Culture of Mutual Trust and Commitment

Departments and contractors should seek to build the culture and relationship with trust and commitment based upon the predefined governance structure and enabled by a stable framework of communication and information sharing.

The partnering relationship should be not only contract-compliance driven but also should advocate cooperative and mutual understanding between both parties, relying on open and frequent dialogue as well as commitment towards contributing to each other's success.

Most outsourcing clients would say that they were looking for a partnership with their contractors. However, this is difficult to achieve in practice. An outsourcing survey* revealed that 45% of the client respondents admitted that they had underestimated the effort involved in managing the contractor relationship (see Figure 5).

Figure 5 – Experience and research show that where the relationship is good, the contract will be a success



In reality, an open and trusting relationship underpinned by hard commercial principles works for both the outsourcing clients and the contractors. Both parties should invest time to exchange information and share understanding of the constraints on both sides. It is also important to encourage the desire to become a successful outsourcing reference case for each other.

[* Understanding misunderstanding: Investing in successful outsourcing relationships – PA's international IT outsourcing survey 2006]

A culture and relationship with mutual trust and commitment between departments and contractors is the best protection against contract failure. The key benefits are that:

- ◆ The service requirements will be clearly and mutually understood;
- ◆ Both parties will work harder to resolve issues and prevent disputes from occurring;
- ◆ Better communications and early sight of forthcoming changes will give both parties more time to plan and respond;
- ◆ Mutual commitment will enable difficulties that do arise to be swiftly resolved.

Departments should seek to build a trusting relationship with their contractors, which may include the following key elements:

- ◆ A shared vision and expectations;
- ◆ Aligned interests and goals;
- ◆ Consistency of actions;
- ◆ Predictability of responses;
- ◆ Mutual respect and understanding;
- ◆ Proactive and intensive communications;
- ◆ Encouragement and participation;
- ◆ Sharing of risks and rewards.

In practice, trusting relationships and collaborative culture can be established by taking practical actions, such as:

- ◆ Notifying successful contractors well in advance;
- ◆ Conducting kick-off meetings with contractors to facilitate the engagement process from the start of the transition planning stage and to get them familiar upfront with the way departments operate;
- ◆ Conducting regular service delivery and contract meetings for ongoing review, providing feedback for continuous improvement, promoting open and clear communication, enhancing mutual understanding and resolving issues together;
- ◆ Involving senior management from both parties periodically to maintain the relationship and ensuring that it stays on track throughout the life of the contract.

The common ingredients of successful relationships will include the following:

- ◆ Departments should understand and respect the contractor's need to make a profit;
- ◆ Longer term contracts should have provisions for continuous improvement in service targets;
- ◆ All contracting profiles and responsibilities should be clearly articulated;
- ◆ Systematic issue identification and resolution techniques should be used.

It is important to remember that departments can outsource services but **NOT** the ultimate accountability. Whilst departments should be alert to faults and frauds and take corrective/improvement actions promptly, they should also adopt a work-together and problem-solving approach to achieve the best outcome for the Government and the service recipients, rather than resorting to the dispute resolution process as the first response. Outsourcing, if well-managed, will become a “win-win-win” situation for the government, contractors and users/customers.

10.5 Guideline 24: Manage the Retained Risks

Departments should also be aware of the risks retained by them after outsourcing, for example:

- ◆ Political and legal risks – changes in government rules and regulations which may affect the existing or future outsourcing contracts;
- ◆ People risks – availability of the necessary skills and competency required to manage the contract within departments; the ability to address human resources issues in relation to affected staff;
- ◆ Delivery risks – disruption of service in case contractors fail to perform.

Departments should seek to ensure the continuous delivery of quality services to the government and the public at all times by:

- ◆ Maintaining good internal communication with relevant staff in departments and keeping them informed of the impact of outsourcing;
- ◆ Developing a contingency plan together with the contractor, and rehearsing it where appropriate;
- ◆ Developing an internal back-up plan in case the contractor goes bankrupt; and ensuring there are potential contractors in the marketplace who can be engaged as back-up resources during contingency situations;
- ◆ Building into the contract that departments or their appointed personnel (including other contractors) have the right to step in and take over the contractor's services or operations when necessary.

11 ENCOURAGING GOOD PRACTICES FROM CONTRACTORS

11.1 Introduction

The Government is committed to ensuring that public services are delivered to the highest practicable standards and in a socially responsible and ethical manner. This applies equally regardless of whether the services are supplied internally by departments or externally by contractors. While departments should manage and enforce contracts, taking legal action should be the last resort in dealing with contractual issues. Departments should cultivate strong and lasting partnerships with contractors through promoting good practices whilst enforcing contractors' compliance with contractual requirements.

This chapter outlines the typical challenges faced by departments in the area of encouraging good practices from contractors and provides the corresponding advice to address them. The handling of malpractices is described in Chapter 12.

11.2 Typical Challenges Faced by Departments

It is difficult, indeed practically impossible to forecast and address all issues exhaustively in a written contract document. Successful outsourcing partnerships will rely on the contractors' self-discipline in delivering quality services in an ethical manner. Nevertheless, some contractors will tend not to go beyond the minimum requirements specified in the contracts since they simply do not see any benefits from exceeding them or exercising good practices.

11.3 Guideline 25: Commitment to Professionalism and Quality

Departments should encourage contractors to demonstrate commitment to sound professionalism and quality. While contractors have their obligations to uphold the highest standards of performance in accordance with the written contracts, they should also be encouraged to operate with integrity, honesty and respect for people in all of their dealings. By exceeding contractual compliance standards and making positive contributions to society, contractors will not only add value to their businesses by delivering efficient and effective services, but also enhance their reputation in the eyes of their customers, employees and other stakeholders.

Departments could introduce their contractors to the services offered by the ICAC's Advisory Services Group, which provides free and confidential corruption prevention services to private sector companies, from formulating staff codes of conduct to reviewing operational procedures.

11.4 Guideline 26: Transparency and Access to Records

The performance of contractors is often a public concern. Some stakeholders (including the Government) have the "right to know" and others (e.g. the public) will want to know details of activities. Departments should encourage contractors to enhance the transparency of their operations and allow open access to information where appropriate, or provide related information for inspection when required. Making relevant information available is a socially responsible practice and is also an effective way to improve stakeholder satisfaction. Departments should therefore encourage contractors to share information with their stakeholders.

11.5 Guideline 27: Avoid Exploitation of Labour

Departments must encourage contractors to demonstrate professional workforce management practices in addition to their contractual and statutory obligations. During contract execution, contractors should not merely pursue profits, efficiency and cost-effectiveness, but also treat their employees in an honest, professional and respectful manner.

Departments and other law enforcement agencies (e.g. the Labour Department, the MPFA, and the ICAC) currently work together to ensure contractors comply with all appropriate regulatory, legal and contractual requirements concerning the well-being, rights and benefits of employees. Departments should encourage contractors to exceed stated minimum requirements, e.g. by providing training to their employees as part of the employees' rights and the contractors' obligations.

Departments should strengthen their roles and responsibilities in monitoring labour issues in relation to outsourced services. To reduce the likelihood and impact of labour exploitation by contractors, departments should consider adopting monitoring measures such as:

- ◆ Posting notices on employment conditions at sites;
- ◆ Setting up labour exploitation enquiry/report hotlines;
- ◆ Setting up a central independent investigation team;
- ◆ Conducting selective checks on payroll records;
- ◆ Interviewing workers to gauge the actual situation.

Whilst departments should strike a balance between the avoidance of labour exploitation and the amount of administrative effort required in detecting and monitoring these labour issues (see Example 49), the need to prevent labour exploitation is of paramount concern and departments should proactively detect and forestall labour exploitation by contractors where possible. Whenever labour exploitation is suspected, departments should seek advice from relevant authorities such as the DoJ, the Labour Department, the ICAC, the Police and the MPFA.

Example 49 – The effort and costs in preventing labour exploitation and detecting/monitoring labour issues need to be balanced

To prevent and detect labour exploitation issues, Department A initially attempted to review all the employee payroll records of its contractors on a regular basis. This monitoring activity consumed a substantial amount of departmental resources and effort. The department then changed to a more focused approach. Instead of verifying all payroll records, it spent more time monitoring closely those contractors who had poor track records in handling labour issues in the past, or whose employees had registered complaints against them. The department continued to conduct regular spot checks for those contractors with a sound track record of complying with labour laws and in handling labour issues.

11.6 Guideline 28: Good Customer and Employee Relationships

Departments should encourage contractors to maintain good relationships with their employees and end customers.

In maintaining good employee relation practices, contractors will benefit from committing fewer operational errors thus lowering business risk whilst achieving higher productivity. Meanwhile, maintaining good customer relationships will help keep customers satisfied. This can be done by:

- ◆ Implementing a credible mechanism to log and handle complaints and feedback;
- ◆ Conducting regular customer satisfaction surveys and acting upon feedback received;
- ◆ Soliciting improvement suggestions and “mining” of good ideas from end customers.

The “word-of-mouth” spread as a result of adopting such practices will in turn help the contractors promote and grow their businesses. After all, promoting good working relations and encouraging good customer and employee communication is a “win-win” strategy for all.

11.7 Guideline 29: Good Behaviour from Subcontractors

Departments should always convey the message that contractors have the responsibility to encourage professional, ethical behaviour from their subcontractors. Contractors will have to ensure that any subcontractors engaged for service delivery are fully aware of the professional, statutory and contractual requirements, and will remain compliant throughout the life of the contracts; otherwise undesirable behaviour from the subcontractors might also affect the contractors’ performance and hence the delivery of the outsourced services.

11.8 Guideline 30: Self-reporting of Operational and Management Information

Departments should encourage contractors to provide management information. Self-reporting by contractors can be a useful and cost-effective management tool, and can provide the basis for constructive dialogue with relevant stakeholders. More importantly, the more management information that contractors disclose, the better the departments will understand the contractors’ operations and performance, which in turn will help maintain a long-lasting partnership (see Example 50).

Example 50 – Reporting samples from a warehouse management system contract

A corporation outsourced its warehouse management system services and required the contractor to provide operational and management information on a regular basis. Some examples of the reporting requirements are shown below:

Services	Reporting details
Order processing	<ul style="list-style-type: none"> ◆ Total number of lines passed to the system ◆ Number of lines keyed vs number of lines allocated ◆ Lines with low margin attributed ◆ Exceptions report where orders are not passed to the system
Inventory	<ul style="list-style-type: none"> ◆ Average number of drops to complete the order ◆ Number of replenishments generated ◆ Number of replenishments completed ◆ Percentage of utilisation of warehouse zones
Orders in the warehouse	<ul style="list-style-type: none"> ◆ Number of lines allocated (to picker) ◆ Number of lines not allocated (to picker). ◆ Number of stock ID errors ◆ Number of lines cancelled/backorders as no product found in location
Despatch	<ul style="list-style-type: none"> ◆ Number of pallets loaded ◆ Number of cases loaded ◆ Number of cases despatched
Customer queries	<ul style="list-style-type: none"> ◆ Accuracy of pick ◆ Accuracy of customer documentation ◆ Have all deliveries been made by carrier ◆ Total number of pallets delivered by customer ◆ Total number of cartons delivered by customer

12 CONTRACTOR MALPRACTICES

12.1 Introduction

Apart from satisfying the service performance targets and accomplishing all their contractual obligations, contractors should not commit any illegal or fraudulent activities or malpractices throughout the life of the contract. This chapter outlines the typical challenges faced by departments and suggests corresponding advice in dealing with contractor malpractices.

12.2 Typical Challenges Faced by Departments

Departments' contract managers and frontline supervisors focus primarily on the contractors' performance and ensuring the delivery of their contractual obligations. As the services being outsourced are getting more and more complicated, staff sometimes do not have sufficient experience in dealing with contractor malpractices or illegal activities or do not know how to report and manage them.

12.3 Guideline 31: Be Alert to Potential Malpractices

Departments should raise the general awareness among all personnel involved in outsourcing activities (including the departments' and contractors' staff) on suspected contractor malpractices or illegal activities. This can be performed through providing training and circulating publications with support from relevant authorities.

Contract managers and frontline supervisors should exercise their professional judgement to identify and be alert to suspected contractor malpractices (such as suspicious arrangements, activities that might indicate uncommon, non-standard industrial practices, complaints on abuse and exploitation of employees). Figure 6 lists the specific roles and responsibilities that they should take to combat contractor malpractices.

Departments should also be alert to any recent, impending or episodic malpractices that are adopted by contractors (e.g. illegal immigrants are more likely to be employed during an economic boom), and identify appropriate mechanisms to combat these malpractices.

12.4 Guideline 32: Partner with Relevant Authorities to Combat Malpractices

Departments should establish and communicate formal, secure channels (such as an e-mail address or a mail box, or references to the relevant departments' enquiry/complaint channels) for relevant personnel to report the discovery of potential or suspected contractor malpractices or illegal activities.

Once reports of suspected cases are received, departments should deploy an independent investigation team/representative to investigate the reported problems and have the assessment results reported directly to senior management or relevant governance bodies.

In addition, departments should maintain close liaison with relevant authorities such as the ICAC, the Labour Department and the Police to exchange intelligence, acquire timely advice on investigation activities and relevant actions to combat contractors' malpractices or fraudulent activities.

Departments should be aware that:

- ◆ There may be legal implications with the sharing of information on suspected illegal activities and malpractices by contractors;
- ◆ Fraudulent acts are normally charged against individuals (e.g. company directors or staff) and there are practical difficulties in penalising contractors on account of the acts of its staff.

Departments are advised to seek advice from the relevant authorities such as:

- ◆ ICAC;
- ◆ Immigration Department;
- ◆ Labour Department;
- ◆ MPFA;
- ◆ Police.

12.5 Guideline 33: Facilitate Contractors' Employees to Report Malpractices

To protect the rights and benefits of the contractors' (and any subcontractors') employees, departments should increase the transparency of employment-related information. They should provide relevant information to contractors' employees and establish channels, such as enquiry hotlines, for them to report contractors' malpractices.

Contract managers and frontline supervisors could also conduct random interviews with contractors' employees to understand contractors' existing practices and detect any malpractices.

Figure 6 – Responsibilities of contract managers and frontline supervisors concerning malpractices

Contract manager	Frontline supervisor
<ul style="list-style-type: none"> ◆ Promote frontline supervisors' awareness of malpractices ◆ Provide a channel for contractor's staff or frontline supervisors to report any malpractices ◆ Perform independent investigation of the malpractices or illegal activities ◆ Escalate unresolved issues to governing bodies such as the steering group or senior management in departments ◆ Refer suspected offence cases to the relevant law enforcement agencies for investigation 	<ul style="list-style-type: none"> ◆ Promote the contractor's/government's staff awareness of malpractices ◆ Communicate the channel for the contractor's/government's staff to report any suspected cases ◆ Be alert to any potential malpractices and assist in early identification of those activities ◆ Report any such activities to the contract manager promptly

13 DISPUTE RESOLUTION

13.1 Introduction

Outsourcing relationships sometimes go astray and disputes may occur. When this happens, a department will need to take appropriate action to bring the relationship back on track, or at least extract maximum residual value from the relationship and minimise the negative impact on the department and the public.

This chapter describes typical issues with dispute resolution and provides advice on how to tackle them.

13.2 Typical Challenges Faced by Departments

Many departments are skillful in performing daily contract management tasks when contracts are running smoothly. However, they often feel uncomfortable when disputes with contractors arise and they may not know how to handle them. A major challenge is for departments to determine whether they should take a confrontational stand against the contractors, whether they should work in collaboration with the contractors to resolve the underlying issues or whether there are any other tactics that they can adopt.

The contract should incorporate measurable performance indicators and payments should be linked to this measurable performance. Such an arrangement will give an early indication of any performance deficiencies. It will also lead to reduced payments to the contractor, which should provide a built-in incentive to perform to the standards required in the contract.

13.3 Guideline 34: Take Appropriate Action Against Non-performing Contractors

Departments are required to take appropriate action against non-performing contractors, depending on the severity and frequency of the performance issues and in accordance with the contract. A monitoring mechanism should be developed and built into contracts to ensure that contractors comply with the contract terms and conditions, jointly work with departments to investigate suspected or reported non-compliance cases and resolve them on a timely basis.

Departments should also include provisions to allow the Government to disclose confidential information, under certain circumstances, to the Public Accounts Committee of the Legislative Council concerning matters relating to mediation settlements, arbitration awards and settlement agreements via any other means of dispute resolution process.

13.3.1 Resolve low-severity issues informally

For non-critical services, when there are early signs that the contractor is not delivering the stipulated performance, the department should make the best use of informal channels and take action for prompt rectification of the problems and issues. The department should work closely with the contractor, taking a problem-solving and continuous improvement approach to investigate the cause of the problem and ensure that the contractor will rectify the situation. After resolving the problem, the department should also seek assurances from the contractor that the same problem will not occur again. Taking a relatively informal approach to problem solving would help maintain a collaborative and trusted relationship between the department and the contractor.

13.3.2 Escalate when severe issues cannot be solved at a working level

If an issue would generate substantial impact on the contract relationship and/or the value of the contract, it is considered to be a severe issue. The department should first attempt to resolve these issues at the working level. If this fails within a reasonable period of time, the contract manager should consider escalating the issue to higher authorities (e.g. the Steering Group for the contract).

The escalation path will vary according to the nature, scope and complexity of the outsourcing contract (see Example 51). Departments must ensure that the escalation path and procedures are well defined and built into the contracts, and communicate clearly to relevant stakeholders so that they understand their own roles and responsibilities.

Example 51 – Dispute resolution procedures should be specified in the contract

For Department A's data centre outsourcing project, the dispute resolution procedures were clearly specified in the contract. The procedures can be summarised at a high level as shown below:



The government's and the supplier's contract manager will try to resolve issues and disputes first.

If the government's contract manager and supplier's contract manager are unable to resolve the dispute **within 3 business days**, the dispute should be progressed to the first escalation point – Service Review Group.

The Service Review Group will be the first escalation point to resolve the disputes internally first.

If the dispute remains unsolved within a maximum of **3 business days** after it has been referred to them, the dispute will be escalated to the Steering Group.

The Steering Group will use best efforts to resolve the dispute within **3 business days** in a way that attempts to preserve the relationship between the parties.

If the Steering Group is still unable to resolve the dispute **within a specified time frame agreed between both parties**, either party may refer the dispute to an arbitration body as stated in the contract.

An external independent arbitration body will act as the final decision panel to resolve the disputes.

13.3.3 Try to resolve the dispute without taking legal action

Departments should try their best to resolve the dispute before considering taking legal action. They could consider adopting the following mechanisms:

- ◆ Alternative dispute resolution such as assisted negotiation and mediation, or simple commercial settlement;
- ◆ Arbitration.

Departments should decide which mechanism would best suit their situation and seek the DoJ's advice on legal issues arising from the dispute as appropriate.

13.3.4 Use Demerit Point System for service contracts relying on non-skilled workers

As promulgated in FC 4/2006, the following DPS requirements will apply to all service contracts (excluding construction service contracts) that rely heavily on non-skilled workers that were invited on or after 1 May 2006:

- ◆ The DPS is required to be implemented against contractors who have breached their contractual obligations in respect of wages, daily maximum working hours, signing of Standard Employment Contract and wage payment by means of auto-pay to its non-skilled workers (except temporary relief workers whose employment period is not longer than seven days);
- ◆ Each breach of these contractual obligations will result in one demerit point;
- ◆ A contract should be terminated under one of the following two conditions:
 - If the contractor or its permitted subcontractors have obtained any specified conviction or obtained three demerit points **over a rolling period of three years** arising from the same contract. The termination should be withheld if the conviction or demerit point is under appeal or review and until the appeal or review has been dismissed by the Court or by the appeal panel of the departments concerned; or
 - If the contractor is subsequently found to have made a false declaration of convictions at the tendering stage.

13.3.5 Terminate the contract and exit from the relationship

Contract termination is the last resort to be sought by departments when dealing with disputes and non-performance. The contract should contain detailed provisions on the mechanism to terminate all or part of the contract and exit from the relationship.

Under the following conditions, departments may consider their rights to terminate the contracts if they are appropriately drafted:

- ◆ Failure to meet the service performance targets for critical services on a repeated basis;
- ◆ Failure to meet a certain number of service performance targets during a specified period;
- ◆ Material breach of terms and conditions with the breach being either irreparable or not having been remedied within a specified period;
- ◆ Major financial difficulties being encountered by the contractors (e.g. under liquidation);
- ◆ Failure to meet mandatory requirements or failure to acquire certain accreditation or licence or approval during the life of the contract.

Special considerations may be needed if the contractor is involved in any merger and acquisition activities.

Departments should also include exit provisions in the contract to cover specific rights that departments will require for termination, such as:

- ◆ The continued provision of the services following the notification of termination and for any run-off period;
- ◆ The right of departments or the new contractors, if necessary, to approach key members of the contractor's staff and to offer them jobs so as to retain the delivery capability;
- ◆ The right to perform inventory check of assets owned by departments;
- ◆ The right to transfer ownership of assets and equipment upon termination;
- ◆ The migration of data and systems and the provision of relevant information to departments or the new contractor.

Apart from termination provisions, departments may also consider the following:

- ◆ Liquidated damages (see 7.4.2);
- ◆ Common law damages (see Glossary);
- ◆ Injunctions (see Glossary).

During the tender preparation stage, departments should think through the above areas and clearly document the related provisions and requirements (such as the conditions to exercise contract termination, procedures to invoke contract termination, contractors' obligations during the dispute resolution and termination periods, payment and financial arrangements, etc) in the contracts.

13.4 Guideline 35: Consult the DoJ and Prepare Thoroughly Before Taking Legal Action

Departments should consider taking legal action against non-performing contractors only when all other dispute resolution methods have been exhausted. Departments should consult the DoJ in the first instance prior to taking any legal action.

Departments will need to prepare and keep the relevant evidence to justify legal action. For example, departments may need to:

- ◆ Keep an audit trail of all correspondence related to the disputes or issues concerned;
- ◆ Collect evidence that departments have performed all necessary steps and have fulfilled all of their obligations according to the contracts;
- ◆ Collect evidence of non-performance or misbehaviour.

14 APPROACHING THE EXPIRY OF CONTRACTS

14.1 Introduction

Many departments, especially those new to outsourcing, may not know what to expect and what to do when an outsourcing contract is about to expire. This chapter describes typical issues encountered upon the contract expiry and provides advice on how to tackle them.

14.2 Typical Challenges Faced by Departments

There are a few common challenges when dealing with the expiry of outsourcing contracts. Firstly, many departments might not know when to start preparing for contract expiry activities. As a result, they often do not have enough time to properly plan for the next step.

Secondly, departments might omit provisions during the tendering process (e.g. in relation to exit management), which are essential to contract expiry or termination. As a result, departments might fail to address issues such as:

- ◆ Asset ownership or transfer;
- ◆ Data protection and retention;
- ◆ Rights for departments or a new contractor to gain access (e.g. access to information, accounts or physical locations);
- ◆ Labour termination and compensation.

All these issues are possible causes of disputes, which could be avoided.

14.3 Guideline 36: Prepare for Contract Expiry at the Tender Preparation Stage

Departments should start to consider contract expiry issues when they develop the tender documentation. They should consider what needs to be done and by whom when the contract expires. The tender documentation should include a number of key provisions, including:

- ◆ The submission of a detailed and regularly updated exit management plan;
- ◆ The submission of a list of assets (owned either by government or the contractors) deployed to deliver the services (for both evaluation and ongoing contract management purposes);
- ◆ Clauses to ensure access to information, assets, facilities and sites by the department, prospective bidders for the new contract and the new contractor;
- ◆ Clauses to protect intellectual property, data, equipment and other assets so that they will be in good condition when the contract expires;
- ◆ Clauses to allow audit of assets by the department, external auditor or a new contractor;
- ◆ A clear definition of ownership of all items in the asset inventory including when items are to be replaced during the course of the contract and provisions for the asset transfer where appropriate

(e.g. what and how assets will be transferred back to the department, options for the department to buy/rent assets on a permanent or short-term basis, asset valuation methodology and processes, etc);

- ◆ Clauses on the need for the retention of key records and documents by the contractor after completion of the service contract for possible future examination or post-contract review.

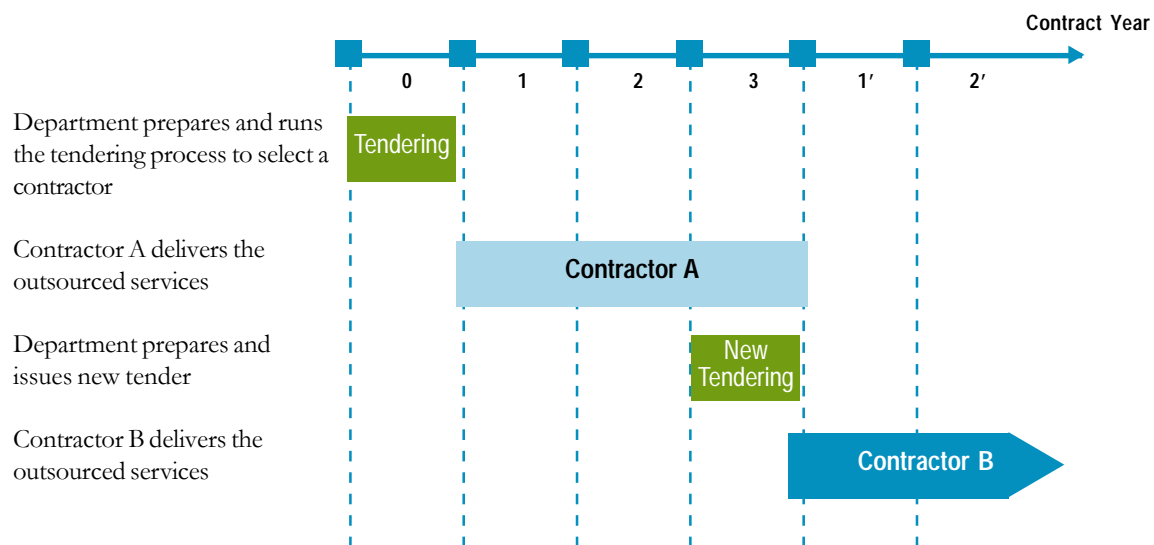
14.4 Guideline 37: Consider Next Steps

Departments should start planning for the next steps about 1 or 1½ years prior to contract expiry. Example 52 illustrates two scenarios. Departments should also note that SPR 520(c) stipulates that any contract extension must be subject to appropriate prior approval.

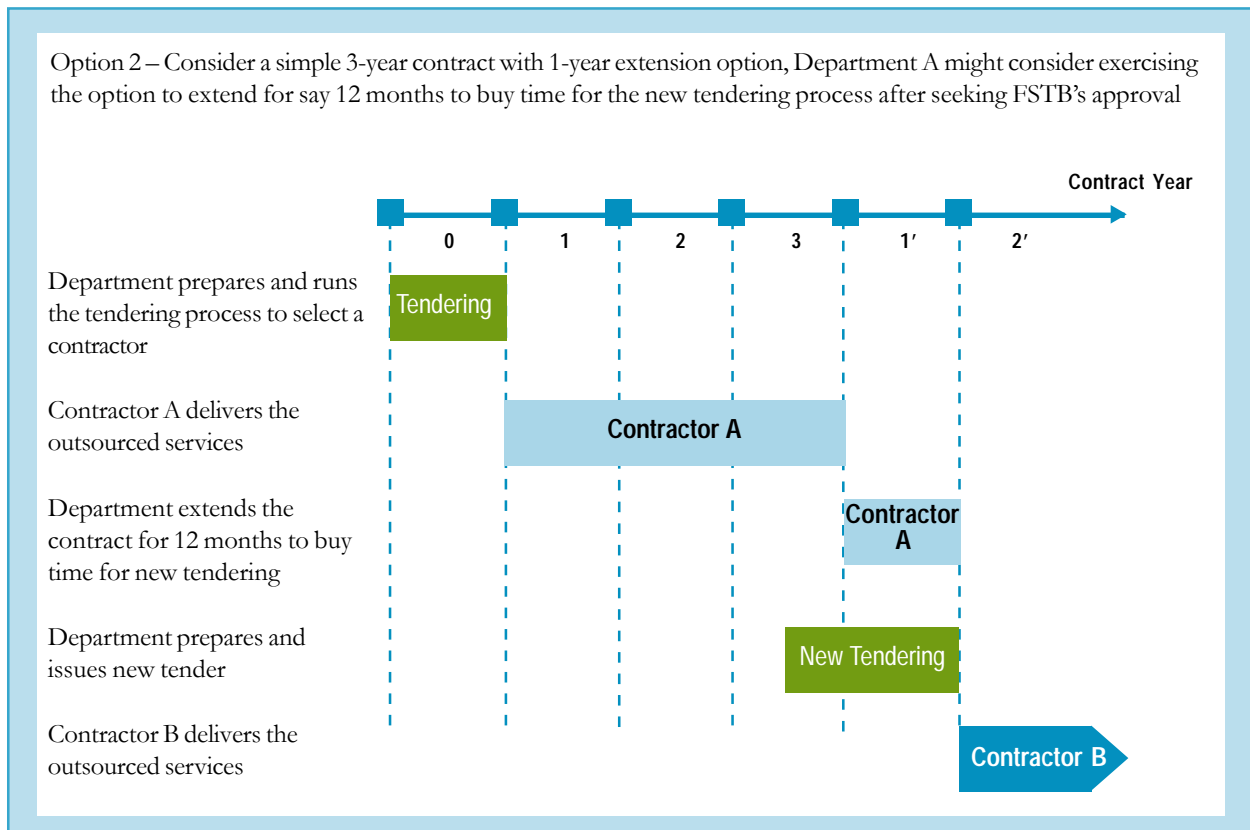
Example 52 – Plan for next steps at least a year before contract expiry

Depending on the nature and complexity of the contract, departments will need to allow sufficient time to plan for next steps. Generally speaking, departments should allow one year to prepare and to conduct a formal tendering process in search of a new contractor. If necessary, and subject to the advice of the FSTB, departments could consider exercising the extension option to buy time for the next tendering exercise. The following diagrams illustrate when the key events should take place, and departments are required to work out an appropriate timetable to plan for and manage the expiry of their contracts.

Option 1 – Consider a simple 3-year contract with no extension option, Department A would need to start preparing for re-tendering a year prior to the contract expiry, so that the outsourced services could be transitioned to a new contractor by the end of year.



Option 2 – Consider a simple 3-year contract with 1-year extension option, Department A might consider exercising the option to extend for say 12 months to buy time for the new tendering process after seeking FSTB’s approval



When considering the next steps, departments should review their requirements, collect market information and conduct benchmarks or research if necessary, and then identify the options available for the way forward. Options open to departments could include:

- ◆ Taking the outsourced services back in-house (See Example 53);
- ◆ Exercising the extension option to buy time for the new tendering exercise when required, after seeking the FSTB’s approval in accordance with the FSTB Circular Memo 4/2004;
- ◆ Running a new tendering process to select the most suitable contractor from the market for a new contract period for the same scope of work;
- ◆ Revising requirements, scope of work or business model, and start a new tendering process to select a new contractor from the market.

Example 53 – Bringing outsourced services back in-house

In Australia, the local authority of Stirling outsourced its leisure facilities to private operators in the 1980s but subsequently did not renew the contracts after the contract had expired. This was believed to have been a combination of the operators not making sufficient profits and the authority’s dissatisfaction with the performance of the contractor. The services were eventually brought back in-house upon contract expiry.

14.5 Guideline 38: Manage Labour Issues

Strictly speaking, labour-related issues arising from contract expiry or termination are the responsibility of the contractor concerned. Nonetheless, experience has demonstrated that departments are sometimes put under pressure for the actions/inactions of their contractors. Departments should be alert to problems that may arise. When a contractor's contract expires, a number of labour-related issues may occur. Even relatively simple issues may be blown out of proportion particularly if there is little time available to resolve them. One key point therefore is that departments should always try to ensure that there is adequate transition time between contracts. This may be difficult to achieve if a contract is terminated before the planned expiry date.

Departments may wish to encourage contractors to :

- ◆ Inform their employees properly of the termination of the contracts;
- ◆ Make suitable arrangements for the transfer of employees to other workplaces;
- ◆ Issue appropriate notices on termination of employment contract and pay all termination compensation in accordance with the Employment Ordinance(Cap 57).

When a replacement contractor takes over upon expiry of a current contract, it is possible that the new contractor may absorb part of the existing contractor's employees. Indeed, in some cases departments may wish to include provisions in their contracts that facilitate the outgoing contractor's staff to be employed by the new contractor. To minimise the likelihood of problems arising, all formalities to terminate the workers' employment with the outgoing contractor should be completed in accordance with the provision of their employment contracts or the Employment Ordinance(Cap 57).

If legally viable, departments may also withhold the payment of the final contract fees or the refund of any deposits to the contractors until it is confirmed within a specified period that there are no outstanding liabilities to the contractors' employees under the Employment Ordinance(Cap 57). Where legally possible, departments may also consider deducting the termination compensation to the contractors' employees from the final contract fees or deposits and paying the contractors' employees directly.

Departments should seek advice from relevant authorities such as the DoJ and the Labour Department.

APPENDIX A

SAMPLE ROLE ALLOCATION

A sample allocation of roles and responsibilities is described in the table below. Departments should consider the nature and complexity of the services to be outsourced and apply roles and responsibilities on a project-by-project basis.

Outsourcing stages	Headquarters		District offices	
	Role	Responsibilities	Role	Responsibilities
Phase A – Developing the business case				
Scope the service	Advisor	Provide advice upon request, and provide examples where appropriate Coordinate the timing and scope of tenders	Owner	Draft scope of the services to be outsourced
Establish service levels	Advisor	Provide advice upon request, and provide examples where appropriate	Owner	Define service performance measures and targets, as well as underlying management processes
Identify costs	Advisor	Provide advice on cost identification and estimation upon request	Owner	Identify existing costs and explore likely range of outsourcing costs
Identify and analyse solutions	Advisor and approver	Provide framework for analysis, possible business models and considerations Review and approve/reject strategy developed	Owner	Identify and analyse possible options
Develop business case and service acquisition plan	Advisor and approver	Provide framework/templates for business case and acquisition plan Review and approve/reject feasibility study and business case	Owner	Conduct feasibility study, develop business case and establish the service acquisition plan Seek advice and approval from the headquarters before proceeding to next stage

Outsourcing stages	Headquarters		District offices	
	Role	Responsibilities	Role	Responsibilities
Phase B – Tendering and selection				
Create tender document	Owner	<p>Provide examples of tender documents or generic tender templates (e.g. service specification, service level agreement, terms and conditions) for similar services that are already outsourced</p> <p>Draft the full set of tender documents (including specification, contract, etc)</p> <p>Seek advice from the management, the DoJ and any other relevant bureaux/ departments as appropriate</p>	Business user	<p>Define the requirements and prepare the service specifications</p> <p>Review the tender document prepared by the headquarters and provide inputs</p>
Establish evaluation criteria	Owner	<p>Provide examples or generic templates on evaluation criteria and marking schemes</p> <p>Draft the evaluation mechanism, criteria and marking schemes</p> <p>Seek advice from the management, the DoJ and any other relevant bureaux/ departments as appropriate</p>	Business user	Review the evaluation criteria and provide inputs
Approach the market	Owner	<p>Provide generic pre-qualification process framework</p> <p>Conduct the market testing/ consultation exercise</p> <p>Brief, as appropriate, potential contractors about upcoming business opportunities during the consultation process</p> <p>[Market testing/ consultation should be distinguished from prequalification process. Market testing/ consultation is not a procurement process. Prequalification is a procurement process and departments should follow the procedures set out in SPR 330.]</p>	Business user	Participate and observe pre-qualification or market testing/ consultation process when required

Outsourcing stages	Headquarters		District offices	
	Role	Responsibilities	Role	Responsibilities
Manage the tender process	Owner	Manage the tendering process from publication, briefing through to handling of bidders' enquiries and closing of tender responses	Business user	Participate in the tendering process when required
Evaluate tender responses	Owner	<p>Conduct technical and price evaluation based on the approved marking schemes</p> <p>Organise bidder presentation sessions to verify the written responses</p> <p>Document the evaluation results in the evaluation reports</p> <p>Seek advice and approval from the management and relevant authorities before proceeding to next stage</p>	Business user	Participate in the evaluation team when required
Conduct due diligence checks and reviews	Owner	<p>Conduct site visits, reference checks and financial vetting to verify the capability and competency of the bidders</p> <p>Seek advice and approval from the management and relevant authorities before proceeding to next stage</p>	Business user	Participate in the due diligence process when required
Negotiate and sign contract	Owner	<p>Provide examples or generic templates of negotiation brief</p> <p>Prepare the negotiation brief and work with relevant authorities (e.g. GLD, DoJ) to conduct the negotiation</p> <p>Seek approval from the management and relevant authorities before signing the contract with the preferred bidder</p>	Business user	Participate in the contract negotiation process when required

Outsourcing stages	Headquarters		District offices	
	Role	Responsibilities	Role	Responsibilities
Phase C – Contract management				
Transition planning	Advisor	Advise on enquiries and issues raised by the district offices	Owner	Work closely with new contractors (and existing contractors) to plan for the service transition Seek advice from the headquarters or relevant authorities where appropriate
Transition	Advisor	Advise on enquiries and issues raised by the district offices	Owner	Manage the service transition/ implementation process and be accountable for the services during transition
Ongoing contract management	Advisor and governing body	Advise on enquiries and issues raised by the district offices Act as the chair or a key member of the steering group to govern the management of the outsourced services and handle any major disputes If required, may conduct ad hoc enquiries or spot checks on the districts or contractors for the outsourced services to verify service quality or investigate complaints and issues Decide what follow-up action should be taken against the contractors	Owner	Manage the contract at the operating level and be accountable for the services after transition Collect relevant information on contractors' malpractices/suspected breaches of legislation once detected and make recommendations for follow-up actions Escalate the malpractices/major issues to the service steering group at the departmental level
Contract reviews	Advisor	Review the contract/extension review reports, and advise on issues if appropriate	Owner	Conduct regular contract reviews and develop the review reports
Contract expiry/ termination planning	Advisor and approver	Approve/reject the extension/ termination plan	Owner	Conduct extension review/ termination planning Recommend extension/ termination plan Seek approval from the headquarters prior to proceeding to contract extension or termination
Exit management	Advisor	Advise on enquiries and issues raised by the district offices	Owner	Manage the exit management process and be accountable for transitioning out the services from the original contractor to a new contractor or to bring services back in-house

APPENDIX B

GLOSSARY

80/20 rule	A guideline stating that for many phenomena, 80% of the consequences stem from 20% of the causes.
Benchmarking	A procedure to compare and verify whether the standard and price of services is consistent with the market standard (if any), without any formal competitive bidding.
Bidders	Contractors who submit bids or proposals for the services to be outsourced
Change management mechanism	A mechanism that handles changes in the service requirements or terms and conditions of the contracts.
Common law damages	Pecuniary compensation, obtainable by success in an action, for a wrong which is either a tort or a breach of contract. The compensation is in the form of a lump sum payment.
Contract management	The management of the outsourcing contract on behalf of the Government. It may be performed by a specialised contract management unit in the department or by the area of the department that has outsourced the service. Its primary functions are monitoring and enforcing service levels and managing the overall relationship between the service provider and the department.
Contractor	Service provider who may bid for/is awarded an outsourcing contract and will be responsible for providing the outsourced services to the outsourcing organisation.
Demerit Point System (DPS)	The DPS is a management tool for monitoring a contractor's performance. Under the DPS, the procuring department will issue a demerit point to a contractor if it is found to have breached the contractual obligations in respect of wages, daily maximum working hours, signing of Standard Employment Contracts with and wage payment by means of auotpay to its non-skilled workers. If a contractor has obtained a specified number of demerit points, its tender offer for future contracts shall not be considered, and/or its contract shall be terminated.
DoJ	Department of Justice
Due diligence	A detailed study to verify the capability and quality of the bidders prior to contract award. In a due diligence check, one or both parties thoroughly examine the viability of entering into the outsourcing relationship. There is no legal definition of due diligence. However, it is generally understood to mean the extent to which a prudent person would carry out investigations on behalf of the party they represent in determining whether a contract they intend to enter into is sound and that all reasonable checks have been carried out to verify information provided by the other party.

EoI	Expression of Interest
EU	Efficiency Unit
Evaluation criteria	The criteria used to evaluate the proposals submitted in response to an EoI, ITT or RFP.
FC	Financial Circular
FSTB	Financial Services & Treasury Bureau
GLD	Government Logistics Department
ICAC	Independent Commission Against Corruption
Input-based specification	A specification that primarily describes the process inputs and step-by-step procedures.
Injunction	An injunction is an equitable remedy in the form of a court order that either prohibits or compels ("restrains" or "enjoins") a party from continuing a particular activity. The party that fails to adhere to the injunction faces civil or criminal contempt of court and may have to pay damages or sanctions for failing to follow the court's order. In some cases breaches of injunctions are considered as serious criminal offences that merit arrest and possible prison sentences
IT	Information Technology
Invitation to Tender (ITT)	A document that the department issues to contractors. The document will request that the contractors reply to a precisely defined requirement in a prescribed format. It is typically comprised of a statement of requirements, a condition of tender document, a draft contract and a format for the tender response.
MPFA	Mandatory Provident Fund Schemes Authority
Outsourcing	An arrangement where a government department contracts with an external service provider for a continuous period for the provision of services specified and usually paid for by the department.
Output-based specification	A specification that primarily describes the desired outputs or outcomes in non-prescriptive terms, leaving the bidders with the room to determine the "what inputs" and "how to do it".
Outsourcing contract	A written contract made between the Government and the contractor to govern the delivery of the outsourced services
PPP	Public Private Partnership
RFP	Request for Proposal
Relationship management	The management of the outsourcing contract relationship between the contractor and the client organisation.
SDR	Special Drawing Rights (SDRs) are defined by the International Monetary Fund in terms of a basket of major currencies used in international trade and finance. The determination of the currencies in the SDR basket and their amounts is made by the International Monetary Fund Executive Board every five years in accordance with the relative importance of the currency in international trade and finance.

Service level agreement (SLA)	A document that defines the service performance standards that a contractor should deliver, how the performance will be measured, who will measure them, who will report on them and how frequently they will be reported upon.
Service levels	Service levels are the standards of service with which the contractor must comply.
SPR	Stores and Procurement Regulations
Spot check	An exercise to validate compliance with procedures by performing impromptu checks on daily activities.
User satisfaction survey	A survey that is conducted to measure the satisfaction levels of the end customers.
Value-for-money	A term that means getting the desired outcome at the best possible price
WTO GPA	Agreement on Government Procurement of the World Trade Organization.

TAKING ADVICE AND GUIDANCE

The EU offers general advice on contract management. It can provide consultancy support by conducting business case/feasibility studies. It also:

- ◆ Assists in preparation of procurement documents
- ◆ Advises on outsourcing and PPP issues
- ◆ Publishes guides and reference materials, and organises and delivers training and seminars on outsourcing and PPP
- ◆ Maintains a list of external management consultants
- ◆ Provides help desk services (Tel: 2165 7255)

The CSB will advise on issues affecting civil service staff

The DoJ will provide assistance on preparation and drafting of procurement documents

The FSTB (Treasury Branch) should be consulted on the appropriate funding and procedures involved in seeking FC/PWSC endorsement. It will:

- ◆ Advise on financial/funding issues
- ◆ Vet funding applications for both capital funding and recurrent consequences and earmark funding for projects in Resource Allocation Exercises
- ◆ Provide support to the process of seeking funding approvals from Finance Committee
- ◆ Advise on tendering issues and vet bid evaluation methodology

The GLD provides advice to departments on general procurement matters under the Stores and Procurement Regulations

The ICAC will provide assistance on managing probity and corruption risks

The LD can advise on measures to mitigate risks in the field of employment (particularly avoiding the exploitation of non-skilled workers by contractors)

The MPFA can provide advice on compliance with the Mandatory Provident Fund Schemes Ordinance (Cap 485)

The OGCIO can advise on projects involving the provision of information technology infrastructure and services

The ImmD can offer advice in relation to immigration related offences

The Police can be approached for advice on handling suspected malpractices or fraudulent activities by contractors

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