Serving the Community By Using the Private Sector

A General Guide to Outsourcing

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(Third Edition)

效率促進組
Efficiency Unit

服務市民
SERVING THE COMMUNITY

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.

FOREWORD

During the past decade there has been a noticeable change in attitudes and perceptions about using the private sector to deliver public services. This has occurred in parallel with the greater use of outsourcing by more and more departments covering a wider range of service areas. Greater exposure and experience has created growing confidence.

We know for certain that the public's expectations continue to increase. The community now expects the government to deliver quality customer services, multiple channels of service delivery, and e-services on a par with the best of the private sector.

If there is to be one single important message which we want to convey through this Guide, it will be the following:

"One can outsource the responsibilities but never the accountability."

This, however, should not deter us from engaging outsourcing as a tool for improving our service delivery and for bringing in service innovation.

While we encourage departments to adopt outsourcing for non-core services, we caution against automatic roll-over of contracts which tended to happen by default rather than by design. Hence this Guide aims to provide a full menu of the processes focussing on outsourcing contract renewal. We encourage readers to read this in conjunction with our other publication - "A User Guide to Contract Management".

Outsourcing is one of the ways of engaging and partnering with the private sector to deliver services to match the community's expectations. It provides departments with an opportunity to innovate and to improve our service design. But outsourcing will only work if it is done well. This third edition of the Outsourcing Guide is designed to help departments meet such challenges. The Efficiency Unit stands ready to offer comments, advice and practical assistance to departments taking up the challenge.

Kitty Choi
Head, Efficiency Unit

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Introduction

Involving the private sector in public service delivery

The Government is committed to providing the best services it can for the community. Its commitment to enhancing public sector productivity and keeping down the public sector's share of the Gross Domestic Product means that departments must examine new ways of providing services other than through the appointment of more civil servants.

Efficient and effective service to the community occurs when the strengths of both the public and private sectors come together

Private sector involvement (PSI) continues to be encouraged within the civil service as a means to improve efficiency, effectiveness and quality in the delivery of services. The main forms of PSI are:

Purchase/Provider Agreements including -
- Outsourcing/Contracting out
- Contracting in
- Grants and Subventions

Public Private Partnerships (PPPs) including -
- Private finance initiatives
- Franchises
- Joint ventures
- Partnership companies
- Partnership investments

Privatisation including -
- Asset sales
- Sales of shares in government owned enterprises
- Management buy outs

These and other forms of PSI are explained in more detail in the Efficiency Unit (EU) publication "Serving the Community by Using the Private Sector - Policy and Practice", available at the EU website (http://www.eu.gov.hk).

This guide focuses on outsourcing of **non-works services** which is an arrangement where a Government department contracts with an external service provider for the provision of services specified over an agreed timeframe and paid for by the department.

Outsourcing is one of the key forms of PSI in Hong Kong. It supports Government's policy of "minimum intervention, maximum support". Over the past few years, Government departments have contracted out many activities including capital development (infrastructure and building) and administrative and maintenance functions (building and property management, cleaning, security, plant and equipment maintenance). Other areas where outsourcing is emerging as a more common choice include the environment, hygiene, training and development and welfare services.

Using this Guide

This General Guide to Outsourcing (Outsourcing Guide) has been developed to meet the needs of civil service managers and staff involved in outsourcing. It discusses steps that should be considered at each phase of the outsourcing process. **In this third edition, emphasis is given to the renewal of an existing outsourcing contract.** Where departments are outsourcing an activity for the first time, suitable adjustments to procedures/consideration should be made. This Guide is also being made available to the private sector so that it can better understand the procedures and practices that are being followed by Government departments.

Within best practice, departments may, nonetheless, adopt different approaches to outsourcing to meet their particular circumstances. It is not the objective of this Guide to lay down a single immutable model of outsourcing. Departments should always follow the relevant Stores and Procurement Regulations (SPR) and Financial Circulars.

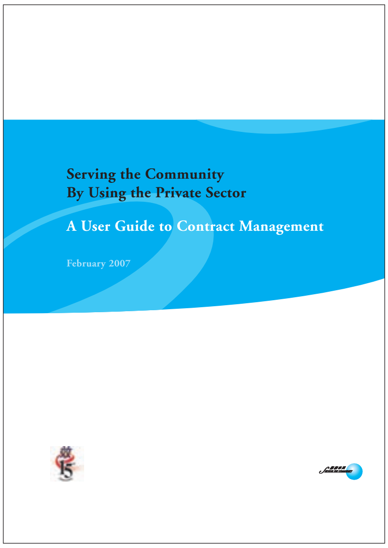
Throughout the Guide the term department is used generically for all types of Government organisations. ***Appendix 1*** provides a glossary of terms and abbreviations.

The EU has also produced “A User Guide to Contract Management” to supplement the Outsourcing Guide. Whilst the Outsourcing Guide focuses on “processes” for approaching outsourcing, the User Guide to Contract Management attempts to address the “content” challenges that will likely be encountered during different stages of the outsourcing process.

Apart from the EU, the Independent Commission Against Corruption (ICAC) has published a best practice guide on Government outsourcing.

The EU is preparing a Government Business Case Guide to provide guidance on how to develop business cases for Government projects.

These and other guides prepared by the EU as well as the ICAC’s best practice guide on Government outsourcing are available in the EU website and in the Central Cyber Government Office (CCGO) website.



1 Outsourcing in the Civil Service

In recent years, the Government has used outsourcing widely to deliver high quality, cost-effective, services and projects. The 2006 Outsourcing Survey conducted by the EU revealed that, as at 31 July 2006:

- There were almost 4 000 government outsourcing contracts, comprising almost 1 000 works contracts (25%) and more than 3 000 non-works contracts (75%)
- The total contract value was a little over $200 billion, of which 65% was spent on works and 35% on non-works services respectively
- The total annual expenditure was a little over $44 billion, 73% spent on works and 27% on non-works services
- For works projects, five departments accounted for 96% of the total annual expenditure of $32 billion: Architectural Services Department (47%), Highways Department (22%), Civil Engineering and Development Department (11%), Housing Department (10%) and Drainage Services Department (6%)
- For non-works projects, five departments accounted for 66% of the total annual expenditure of $12 billion: Housing Department (29%), Architectural Services Department (12%), Environmental Protection Department (11%), Food and Environmental Hygiene Department (8%) and Leisure and Cultural Services Department (6%).

Given this extensive use of outsourcing it is imperative that departments focus on ensuring that their outsourcing projects achieve value for money. The quality of service goes hand-in-hand with cost. In some cases improving quality may mean greater cost; reducing cost may mean compromising quality. Balancing the trade-off between cost and quality is what is meant by achieving value for money. (A checklist of issues to consider in achieving value for money is given at ***Appendix 2***).

Obtaining value for money should be a key objective in every outsourcing project

Value for money comes from the effective, efficient and economic use of resources.

Effectiveness is sometimes expressed as “doing the right thing”. It is a measure of the extent to which objectives have been achieved.

Efficiency is sometimes expressed as “doing things right”. It is a comparison of the output achieved with the resources used to produce it.

Economy is concerned with minimising the cost of resources used for an activity, having regard to appropriate quality.

1.1 Reasons for outsourcing

Outsourcing is not an end in itself. Its successful adoption involves departments in making important decisions about the business they are in and the best mechanism for delivering their services to the community. Outsourcing is a management tool and should be approached in that manner. In letting an outsourcing contract, whether for the first time or as a renewal exercise, the first step is to determine the primary reasons for the outsourcing.

Departments often outsource to acquire services that are unavailable in-house. While outsourcing in many cases generates savings, cost reduction however is often not the main reason.

Departments outsource mainly to acquire services unavailable in-house, not to reduce cost

For each outsourcing contract it is important to identify the reasons for outsourcing so that these may be reflected in the development of the service requirement and in the tender evaluation process. The main reasons given by departments in the 2006 Outsourcing Survey included:

1	Unavailability of service in-house	9	Policy changes
2	Focusing on core services	10	Achieving defined service levels
3	Making up for staff shortages	11	Improving service output
4	Access to skills	12	Access to information
5	Reduction in costs	13	Facilitating organisational changes
6	Flexibility in service delivery	14	Converting fixed costs into variable costs
7	Improving service quality	15	IT legacy system support
8	Access to technology	16	Risk diversification

A more detailed discussion of some of the main reasons adopted by departments is given below:

Focusing on core services. Successful outsourcing allows the civil service to focus in-house resources on tackling priorities. In general these priorities will be policy formulation, regulatory control and statutory service delivery functions. When a department concentrates on carrying out its priorities, it can use its financial, human and management resources more effectively and efficiently. Outsourcing of some non-core functions provides departments with the flexibility to redirect and focus their resources on activities critical to their mission.

Nonetheless, priorities may differ from time to time and from department to department and no function should be treated as automatically immune from regular consideration as to its potential for outsourcing. Departments should be cautious of being restricted by definitions of "core" services.

Access to skills. Departments may experience a shortage of skilled and experienced staff brought about by the change in the business operation landscape, retirements, resignations, caps on recruitment or an inability to recruit into the civil service. Existing staff may not always have the necessary skills to keep pace with rapidly evolving technology. In general, departments will source core function skills through recruitment and use outsourcing to access skills that they find difficult to recruit and retain.

When a department is contemplating providing new services, outsourcing can ease the process of building the skills and resources required to respond to these new initiatives. In some cases, outsourcing to an external service provider may be the only practical way to access the skills necessary to properly deliver services.

Departments may also benefit from having their staff work with the service provider's specialists. To ensure a department's interests are well served, contract managers will need to keep their own knowledge up-to-date.

Reduction in costs. Budget realities have an impact on deciding which functions are to be performed in-house and which to be outsourced. In many cases outsourcing can reduce both capital and recurrent costs. The 2006 Outsourcing Survey results reflected that average savings of about 27% per annum had been achieved for non-works services that were originally delivered in-house.

Flexibility in service delivery. Maintaining the level of equipment and staff necessary to cover peak loads can leave a department with under-utilised resources during off-peak periods. Conversely, a department may only be able to maintain resources at a level just sufficient to meet normal demand, leading to poorer customer service at peak periods. Outsourcing of functions that are subject to peaks and troughs in usage can provide a department with the flexibility to respond rapidly to changing demands.

Improving service quality. In an era of increasing specialisation and rapid advances in technology, many departments find it necessary to keep pace with the best practice in the private sector. There are also indications that the public is becoming more demanding, with many expecting the public sector to match private sector service standards. In the public sector, outsourcing can be an effective tool to improve the quality of services. Private sector service providers are not bound by government procedures and practices. They may have more flexible, innovative and effective ways of delivering services and ensuring the services reach the people they are meant for. Examples of this might include offering longer or more flexible service hours built around end users' requirements and providing access to services via technology.

Access to technology. Departments also look to outsourcing to keep up with the accelerating changes in technology. Service providers often have more funds or expertise to acquire and maintain new computing/telecommunications resources than Government departments. They are also able to implement new technology better and more quickly because market competition drives them to maximise their return on technology investment with continuous technology refreshment.

1.2 Key issues to be managed

In pursuing an outsourcing contract, whether for the first time or on renewal, care should be taken to consider the following key issues:

There may be issues affecting the outsourcing decision that seem unique to government - but they are not unsolvable

Legal issues. The Government's extensive constitutional and common law powers to enter into outsourcing contracts may be determined by specific legislation. For example, an ordinance might require that a particular function be carried out by a public officer or by a specific departmental officer. The possibility of legal constraints on the scope of an outsourcing proposal must be identified at an early stage. Departments must make sure at the outset that they have all the necessary legal and administrative power and authority to embark on the proposed outsourcing. The Department of Justice (DoJ) can advise if the legislation in question is unclear, and whether any part of a proposed outsourcing would be "ultra vires", i.e. beyond the legal power of the Government.

Remuneration. Departments must ensure that any proposed manner of remunerating the contractor is consistent with the requirements of the Public Finance Ordinance (PFO) (Cap. 2). Under Section 3 of the PFO, all monies raised or received for the purposes of Government form part of the general revenue. No expenditure may be charged on the general revenue unless authorised by legislation or in accordance with the appropriation process specified in Cap. 2. Hence, when a contractor is permitted to collect fees or revenue for Government, it must not be allowed to net-off its own remuneration unless this is expressly permitted under legislation or is approved by the Finance Committee.

Privacy, confidentiality and security. Departments often maintain records of individuals' private or confidential information. Outsourcing a service might require such information to become available to a private sector service provider's employees. Departments, as the data users, must observe the fair information practices stipulated in the six data protection principles in Schedule 1 of the Personal Data (Privacy) Protection Ordinance (Cap. 486) in regard to the proper use of personal data and the security of personal data. Where personal data of employees is involved, departments should also refer to the Code of Practice on Human Resource Management (available from http://www.pcpd.org.hk) issued by the Office of the Privacy Commissioner for Personal Data to ensure the integrity, prudence and competence of the staff having access to personal data.

Departments often express concern that the private sector cannot be trusted to guard confidential information. This is rather curious since many private firms and overseas governments have successfully outsourced services that involve the handling of sensitive information.

Knowledge of government. Civil servants, by their training and experience, are expected to have a very close knowledge and understanding of public service requirements. It is the responsibility of the outsourcing department to define precisely the knowledge required and ensure that any contractor staff delivering a service are provided with the knowledge and understanding to properly carry out the activities required.

Flexibility. A typical outsourcing contract will often run for several years. No matter how well the service requirements are defined in the contract, it is inevitable that some requirements will change over time. Inflexible contracts could result in outdated services/technologies or create disputes with contractors during the life of the contract. Departments should consider including change management mechanisms in the contract to cater for service scope variation during the contract period. Further guidance can be found in Section 7.5 of the User Guide to Contract Management.

Sharing information and practices. Sharing information and practices in outsourcing projects is important in avoiding unnecessary duplication of resources. For some departments, because of insufficient communication, different district offices may have adopted different practices and yardsticks even when similar services have already been outsourced in other districts. Departments are encouraged to strengthen communication between different offices in relation to outsourcing practices. Further guidance on how to ensure good internal departmental communication can be found in Chapter 4 of the User Guide to Contract Management.

In-house expertise. When departments find that the necessary skills and experience required to manage all or part of the outsourcing process are not available in-house, it may be more effective and efficient to seek assistance from other departments. Alternatively, departments can bring in external specialist consultants. Moreover, the department must assure itself that appropriate knowledge transfer takes place and that it is able to manage the outsourcing project after the departure of the outside party.

Disengagement. There may be concerns about the ability of the Government to terminate an outsourcing contract and revert to the previous internal service delivery arrangements or engage another more suitable service provider. In every outsourcing project departments must assess the impact of the service provider not being able to perform the service, e.g. the service provider goes out of business during the contract period. An integral component of the outsourcing process must be to identify and set up plans to minimise and mitigate this delivery risk. Arrangements for disengagement will be less complicated if this risk is taken into account at an early stage. Please refer to Section 10.5 of the User Guide to Contract Management for further guidance on managing retained risks.

Political environment. The possibility of an outsourcing project becoming politically sensitive must be addressed during the planning process. Areas of sensitivity may include the impact of changes on existing staff, external clients or the community more generally. A department considering outsourcing of services should examine how stakeholders will be affected by a shift from in-house provision to private sector service delivery, what their reactions might be and how to build appropriate communication into the planning and development process.

Internal and external consultation. For most outsourcing projects, the human implications require close attention from the outset. It is sensible to ensure that all internal stakeholders, particularly staff, are aware of the project, the project timetable, and the impact the project may have on them or those they represent. Close liaison and co-operation with staff are more likely to lead to better outcomes than the adoption of a non-consultative approach.

During the planning process, staff should be kept informed. There should be regular and open communication throughout the outsourcing project. If the staff belonging to a grade managed by another department or general grades managed by the Civil Service Bureau are likely to be affected, it is important to involve the responsible grade management early in the planning process.

Where the service delivery impacts upon external stakeholders, departments should consider the timing and extent of consultation with end users, District Councils, advisory bodies, etc. Including end users' inputs in the specifications of requirements will help ensure that the services delivered will meet the end users' requirements.

Transitional issues have to be considered early in the preparatory stage

Transitional issues. Departments should start to consider transitional issues when they develop the tender documentation. Some of the transitional issues which are possible causes of dispute are: asset ownership or transfer; data protection and retention; rights for departments or a new contractor (e.g. gaining access to information, accounts or physical locations, etc.); and labour termination and compensation. Departments should consider carefully what needs to be done and by whom when the contract expires. Please refer to Chapter 14 of the User Guide to Contract Management for further guidance.

1.3 Accountability for delivering services

Government does not cease to have any obligation (to the public) after outsourcing the service

Departments should note that they can outsource services but **NOT** the ultimate responsibilities. While an external service provider acts as the agent for delivering services, the outsourcing department remains accountable for the services. The private sector service provider is responsible for delivering the services in accordance with the contract terms, for compliance with legislation, and for remunerating its staff. Nonetheless, the outsourcing department is ultimately responsible to the public for ensuring that the services are delivered at the specific time in accordance with the required standard and quantity, etc.

Experience has shown that the public and politicians will always hold the Government responsible for public services irrespective of the mode of delivery. The wider risk that the public is deprived of the services stays with the outsourcing department and cannot be transferred. In outsourcing projects, departments should always establish sufficient control over the outsourced activities by putting in place appropriate measures to manage the regulatory and political/reputational risks and to safeguard the public interest.

1.4 The main outsourcing stages

The three main stages of renewing an outsourcing contract are set out below. Details will be described in the subsequent chapters.

Chapter 2 **Review of the Required Services**	**Chapter 3** **Tendering and Selection**	**Chapter 4** **Contract Management**
Tasks	**Tasks**	**Tasks**
• Review the business need • Review the service delivery arrangements • Develop the outsourcing model • Set transition and implementation requirements	• Prepare detailed service acquisition plan • Create tender documents • Establish the evaluation process • Approach tender board • Manage the tender process • Evaluate tender responses • Conduct due diligence checks • Negotiate the contract • Obtain clearance to finalise the contract	• Implement the transition plan • Manage the relationship • Monitor service delivery • Monitor benefits achieved • Administer the contract • Seek continuous improvement
Key Issues	**Key Issues**	**Key Issues**
• Does the required service align with the department's business objectives? • Have the previous outsourcing objectives, if applicable, been achieved? • What are the project objectives? • Does outsourcing offer the best option to provide the service? • Are there any obstacles to overcome? • What level of service is required? • Is innovation and improvement encouraged? • What is the most appropriate outsourcing model?	• What is the most appropriate tendering strategy? • Do the tender documents provide all necessary information? • What evaluation method will be used? • Is the tendering process ethical and defensible? • Which service provider is best? • Will the recommended service provider satisfy requirements? • Have transition and implementation requirements been met? • Does the negotiated contract satisfy service requirements and provide sufficient risk mitigation?	• Are transition plans realistic and practical? • Are staffing and asset management issues resolved? • How will the relationship be managed? • Are there systems to monitor performance? • How will performance issues be handled? • Are services being delivered according to the contract? • Are anticipated benefits achieved?
Indicative timeframe	**Indicative timeframe**	**Indicative timeframe**
• 4 – 8 weeks	• 10 – 30 weeks	• 4 – 12 weeks for transition planning
Deliverable	**Deliverable**	**Outcome**
• Approved outsourcing plan	• Signed contract	• Service delivered and performance monitored

1.5 Support processes

The support processes should extend across the three stages of an outsourcing project to ensure that the outsourcing process is defensible and that the resulting contract is an ongoing success. These processes address the key areas of project management, change management, quality management, risk management, issues management, financial management as well as records management.

Project management. To achieve successful outcomes, departments should ensure that there are sufficient resources to support each stage of an outsourcing project. One common way to achieve this is to appoint specific personnel or establish a project team to be responsible for providing the necessary support. The following core skills should be available, though not all of them are required at every stage:

- Sourcing of market knowledge
- Technical/operational
- Change management
- Legal
- Project management
- Problem-solving
- Financial analysis and modelling

Depending on the size of the project, some of the roles may be assumed by one person or by several. Some members of the department's outsourcing project team may not work directly for the department. Consultants, for example, may provide:

- Support services, such as facilitation of business case development and preparation of service level specifications
- Specialised knowledge or expertise, e.g. a financial analyst may be used to produce a financial model to help monitor the performance of the contractor.

Appendix 3 looks at the composition and roles of an outsourcing project team and a contract management team.

Strong project sponsorship is an essential component in project management. The project manager must understand the criteria for effective sponsorship and must actively cultivate such sponsorship for the project. While a project should have one sponsor who initiates and effectively owns the project, there may also be several secondary (or sustaining) sponsors, each filling a different role in the project management process.

> For example, a procurement outsourcing project may have the Assistant Director (Finance) as a major sponsor. Other sponsors may be key users of the service and other parties with a vested interest. Sections that require the services of the procurement unit on a regular basis will have important interests to be addressed.

Change management. Being able to implement the changes in relation to service outsourcing is key to the success of a project. These changes include all the necessary operational changes such as processes, staff, organisation structure, skills and competencies, information technology (IT) systems, etc. In particular, departmental staff may experience or anticipate sudden and dramatic changes in their work environment when their departments implement outsourcing projects. As a result staff may resist strongly. Understanding the level of change a project will cause is the key factor in determining the level of emphasis to place on human and organisational factors before and during implementation.

Successful implementation of the changes associated with outsourcing projects requires careful planning, teamwork, commitment, and stakeholders' buy-in.

Human resources issues should be given priority throughout the project. Much of the success of the transition and implementation will depend on the willing participation of staff affected by the outsourcing of a service.

In order to obtain the willing participation of staff, the following issues should be considered:

- Engaging staff from the start of the project, e.g. seeking advice on transfer and other related issues
- Communicating to staff to maintain transparency, e.g. developing communication strategy for the project
- Managing surplus staff, e.g. handling resignations, considering and finalising future staff postings.

Quality management. Quality management is continuous throughout the life of an outsourcing project. The approach should be defined and the procedures put in place as part of the planning process. Quality in any project is achieved when all deliverables are produced:

- According to specifications and standards
- Meeting users' needs and expectations
- In a manner that is perceived by the department as successful.

Risk management. The objective of a risk management process is to minimise the impact of unplanned incidents on the project and on the department by identifying and addressing potential risks before negative consequences occur. After potential risks are identified, the exposure is determined in terms of the consequences of negative events and the probability of their occurrence. Risk management is therefore concerned not only with identifying risks, but also with reducing risks to an acceptable level.

Potential project-level risks should be identified during the initial planning effort and updated during the different stages of outsourcing. An ongoing risk management process should then be carried out formally as part of the detailed planning and development process. The risks identified must be monitored conscientiously and acted upon speedily. A process for risk management is discussed in ***Appendix 4***.

Where necessary, departments should consider devising their own contingency plans to address the risk of service disruptions. Departments with a high level of outsourcing activities should also consider developing a departmental contingency plan.

Issues management. The primary objective of issues management is to establish a standard method to document and analyse the issues encountered, and formulate solutions. Structured and comprehensive procedures for managing issues reduce project risks and are key to successful implementation of any outsourcing projects.

Financial management. Financial management involves ensuring that the outsourcing project is in line with the department's overall financial management strategy and practices and that it continues to do so throughout the life of the project. This is achieved by regularly reporting to senior management on the progress, scope and cost of the project.

Records management. All records that are created and received during different stages of an outsourcing project, whether paper-based or electronic, should be captured in the department's record keeping system(s) in accordance with the department's record keeping policies, procedures and practices. Adopting a systematic approach in records management will enable the department to:

- Provide evidence of business conducted and decisions made
- Manage legal and other risks
- Meet its accountability obligations
- Facilitate future reference and queries
- Capture and share lessons learnt.

Good and proper record keeping should be seen as an integral part of, rather than incidental to, any outsourcing project.

2 Review of the Required Services

Key tasks

- Review the business need
- Review the service delivery arrangements
- Develop the outsourcing model
- Set transition and implementation requirements

Guidance on the development of a full business case for Government projects, including outsourcing projects, will be provided in the EU's Government Business Case Guide, which will be available in 2008.

2.1 Review the business need

Before a department decides to renew a contract, it should re-examine whether the outsourced service should continue to be provided and consider whether its scope should be revised or not.

2.1.1 Align the service with the department's business objectives

This step consists of ensuring that the outsourced activity continues to contribute to the department's business objectives and determining how it relates to the department's strategic position, its objectives for the future, and any other services that may interface with those under consideration.

Depending upon the nature of the outsourced service, a study should be carried out to consider the environment in which the service area operates, and any impact of Government policy or regulations on the future outsourcing of this service area. The study may be conducted by the department's own staff or by a third party, e.g. an external consultant.

For example, in outsourcing IT management and servicing, the department needs to consider how the use of technology in the delivery of services will evolve, the impact of this on future service direction and whether this is likely to change over time. These issues will focus attention on the Government's service-wide Digital 21 Strategy for Hong Kong and the role of technology in the department's medium term business strategy. These key considerations will affect the form of any alternative delivery arrangements considered and the final development of the business case.

Consideration should also be given as to whether there are potential synergies, between the outsourced activity and other areas of departmental activity, which could be achieved through broadening the scope of the outsourcing.

For example, cleansing, security, building management and electrical and mechanical maintenance services are all related to the management of a property or facility. When looking at outsourcing any one of these functions, it is a good idea to consider outsourcing the others. In most cases having a service provider responsible for providing related services can improve the overall cost-effectiveness and service levels because of synergies and flexibility of resource deployment.

2.1.2 Prepare a high-level statement of service requirements

Once the service need is confirmed and the service scope is defined, the department should prepare a high-level statement of service requirements. The statement can be drawn up based on relevant information in the existing contract with adjustment for future requirements. It should include the following:

Description of the environment. This may include the whole department, interacting units, geographical locations, systems and infrastructure.

Description of the requirement. This describes what the service is and constitutes the main part of the service specification. It is advisable to involve staff currently providing the service and the end users, as they are often best placed to provide an accurate and realistic picture of the current requirements. The following should be documented:

- What the service is and who are the clients of the service
- The required outcomes, taking into account the future service requirements
- Relationships between the service and other units/functional areas, either inside the department or in another organisation

For example, finance and administration units generally have an organisational relationship with procurement units. Each existing organisational arrangement or process that links these functions needs to be examined. The examination should include the technology used to connect the different functions; descriptions of where interrelated tasks or processes begin and end; and an overview of how each unit is involved in the process. This will determine the scope of the service performed and whether any of the boundaries should change.

- An inventory and description of third party contractual obligations – existing contracts may form part of the services to be outsourced and will need to be either phased out or maintained within the new outsourcing arrangements
- Disaster recovery and service continuity requirements – this is especially necessary for services with a direct impact on the public
- Any identified opportunities for process improvement, the realisation of which could produce better outcomes.

2.2 Review the service delivery arrangements

This step involves a review of the existing outsourcing arrangements and a high-level assessment of other options for service delivery in order to decide whether to proceed with outsourcing.

It is important to reflect on experience before renewing an outsourcing contract

Issues to be examined in the review may include:

Achievement of outsourcing objectives

- Have previous/existing outsourcing delivered the anticipated benefits?
- Has value for money been achieved?
- Has the required level of service been delivered satisfactorily?
- Were stakeholders' requirements met?

Changes in environment

- Has the department's strategy for service delivery changed?
- Have there been any changes in Government policy or law, which may require a change in service scope for the next contract?
- Is there any significant change in the service provider market?
- Is there any significant change in end-users' requirements/expectations?

Sourcing options and improvement opportunities

- Is there any better alternative to the existing outsourcing arrangement?
- If the outsourcing is to be continued, do any alterations need to be made?
- Was the service acquisition strategy effective in the selection of capable contractor(s)? Is there any need to revise the tender marking scheme?
- Is there any scope for improving the outsourcing arrangements (e.g. contract/service bundling, contract duration, level of service, pricing model)?
- How well did the contract management regime work? Was the performance assessment and monitoring mechanism effective?

If significant change to the existing service delivery arrangements is proposed, the department should assess the risks involved and develop appropriate mitigation measures. Guidance on risk analysis is given in ***Appendix 4***.

The outcome of the review should be an estimate of the costs, benefits and risks of each option identified and a recommendation of the best option for the department to take. If the option to proceed with another outsourcing contract is clear and approved by the department's management, the next step should be the development of an outsourcing model.

2.3 Develop the outsourcing model

2.3.1 Engage the market

It is advisable to evaluate the market and obtain feedback to shape the future outsourcing model. It is particularly useful where there is uncertainty over the market's capability and interest, how to package the requirement, or where the department wants to attract new service providers. It is also helpful if the department plans to introduce new services or substantial changes to the existing outsourcing model. By engaging the market, the department can focus its effort on what the market can deliver and develop a commercially viable contract.

There is no established procedure for engaging the market. This could be conducted by having informal discussions with potential service providers or through a more formal market sounding or Expression of Interest (EoI) exercise. In general, a department seeks to:

- Identify potential service providers and their interest
- Research market capabilities and experience in delivering the services being considered

- Identify any market deficiencies or constraints inhibiting private sector provision
- Evaluate the options offered by the market
- Estimate the likely costs involved.

Generally, departments should try to minimise the time lag between engaging the market and the subsequent Invitation to Tender (ITT). If there is a lengthy time lag, departments may need to engage the market again before finalising the tender documentation. Experience has shown that changes in the market situation could render prospective tenderers, who have shown interest in earlier market sounding or EoI exercises, no longer capable of or interested in providing the service. A reduced number of bidders could adversely affect the outcome of the outsourcing exercise.

Carrying out market testing/sounding is particularly useful when the department is considering outsourcing a service for the first time and no known service providers exist in the local market. Early market testing allows potentially interested parties the time to explore how they might meet the departments' requirements, e.g. importing personnel with the necessary skills and experience, training, etc.

2.3.2 Prepare the service specifications

After engaging the market, the outsourcing department should further develop the high-level statement of service requirements (see Section 2.1.2) into a detailed specification to describe the services to be outsourced. The specification also defines the standard of the services to be delivered in order to satisfy the department's objectives. In developing the specifications, the department should take into account its future service requirements which may differ from the current ones.

The table below shows some guidelines for developing service specifications.

Departments are advised to develop service specifications by addressing the following:
- Outsourcing objective
- Scope of work
- Work volume information
- Key stakeholders' roles and responsibilities
- Work statements
- Performance measures and targets
- Performance monitoring mechanism
- Performance assessment plan
- Management plan, work plan, contingency plan and quality assurance plan
- Performance-linked incentive scheme
- Remedial actions for non-performance.

In developing the service specifications, departments should:
- State both the mandatory and desirable requirements clearly, concisely, logically and unambiguously
- Focus on the required performance results rather than how the work is to be performed
- Provide adequate information for tenderers to decide and price the service they will offer
- Specify measurable performance outcomes for assessing the contractor's performance
- Avoid under- or over-specifying requirements
- Include only the essential characteristics of the requirement.

All service specifications should be:

- **S**pecific
- **M**easurable
- **A**chievable
- **R**elevant
- **T**ransparent.

Some components of a service specification are described below.

Contracting parties' responsibilities. Both the department and the service provider will have responsibilities in the outsourcing project. Each party's responsibilities are determined by analysing the entire service scope and allocating duties to be performed for each element of the service requirement to either party. Broadly, the service provider is responsible for day-to-day service operations while the department monitors the provider's performance.

The following is an example of each party's responsibilities.

The department will be responsible for:

- Specifying the service requirements
- Advising the service provider of operational requirements
- Ensuring that users (internal and external) are aware of the scope of the services to be provided and any new procedures arising from outsourcing
- Monitoring adherence to agreed policies and procedures relevant to providing the service
- Advising the service provider of changes to the service requirements and facilities likely to have an impact on current and future use of the service
- Managing the relationship to ensure issues are resolved quickly
- Consulting the service provider on all relevant contracts between the department and third party contractors that may have an impact on the service provider's service delivery
- Meeting the service provider regularly and on a need basis, and providing timely and constructive feedback on performance.

The service provider will be responsible for:

- Providing the agreed services
- Managing the service and suggesting improvements
- Responding to service requirements articulated by the department and changes to facilities likely to have an impact on current and future use of the service
- Managing the relationship to ensure issues are resolved quickly
- Consulting with and seeking the department's agreement to any proposed arrangements for all relevant third party contracts that may have an impact on the service provider's delivery of the services
- Obtaining written confirmation on estimates and quotations before undertaking any chargeable activity that will affect the price of the contract or the delivery of the services
- Providing timely, relevant and accurate reports on service performance.

Service requirements. The requirements should be described in terms of "what" the required outputs/outcomes are rather than "how" the work is to be performed. This encourages innovative proposals from bidders and provides greater flexibility to service providers in service delivery. It also facilitates the preparation of the Service Level Agreement (SLA) to measure the service provider's performance. The table below compares input-based ("how") and output-based ("what") requirements.

Service requirements should as far as possible focus on outputs not methods

Comparison of input/output statements for the service level required

Input-based	Output/Outcome-based
Floor 11 of the building must be cleaned • By a minimum of five staff • Using Acme detergent and Acme mops • Once a day • To the standard required • Not during business hours	Floor 11 of the building must be cleaned daily to the standard required and not during business hours
• The call centre must be staffed 24 hours a day, seven days a week • There must be 20 staff available to answer calls at any given time • The telephones must be Lucent telephones • The staff will wear headsets at all times	80% of incoming telephone calls must be answered at all times within three rings, with an average call answering time of two rings

While output-based specifications are generally preferred, departments should note that in practice it is difficult to prepare a 100% pure output-based specifications. Sometimes it is also appropriate to supplement the "what" requirements with a small number of "how" requirements in order to avoid misunderstanding and to set the right expectations.

Further guidance is provided in Section 7.3 of the User Guide to Contract Management.

Service level agreement. The SLA defines the service performance standards that a contractor should deliver and the arrangements on performance measurement. The department will need to look at each of the service elements to be outsourced; determine the standard required of each; and decide how it will be measured. Service standards define the level of service that the department will expect from the service provider. They can be defined by point of delivery, availability, reliability, response time, resolution time, measurement period, responsibility for measurement, reporting frequency and method:

Service level standards must be measurable

- **Point of delivery** is generally described under one of the following categories:
  - Location, which is the geographic location(s), building(s) and/or departmental point(s) at which delivery takes place (the address(es) where the services are physically delivered); and/or
  - Medium, which defines the place(s)/device(s) to or from which the service is delivered. This could be a mobile phone receiving signals or a computer network linking up workstations.

- **Availability** is the amount of time that the service is actually available. This is defined as a percentage of the measurement period(s) chosen for reporting purposes

> For example, an equipment maintenance service may be described as requiring the equipment be available for use 99.9% on a 24-hour x 7-day basis. For a security service the service may need to be available 100% of the time - 24 hours a day, 7 days a week.

- **Reliability** concerns the maximum acceptable number of individual faults over a measurement period. The service definition will have to make clear what constitutes acceptable or minimum service quality

> For example, the number of acceptable faults in an IT system over a period of a month may be: 1 fault classified as high priority; and 5 faults classified as medium priority. For a rubbish collection contract, reliability may be defined as the maximum percentage of rubbish bins that have not been emptied within a specified period of time.

- **Response time** is generally measured by the time taken by the service provider to detect and respond to the occurrence of a fault and/or user request, by providing the required service support

> For example, in a facilities management contract, the response time for attending an emergency situation may be 10 minutes for indoor area and 20 minutes for outdoor area. A cleaning service may need to be on call to clean up spillage or other accidents. In a high use building, the response time to this will be more critical than in a low use building. The cleaners should be required to respond within a specified time from the accident being reported.

- **Resolution time** can be defined as the acceptable time for resolving the fault. It is measured from the moment the fault occurred to the moment the fault is resolved

> For example, a high priority fault may be required to be resolved within 1 hour of the fault occurring. A medium priority fault may require resolution within 3 hours of the fault occurring, and so on. For a home meals delivery service, a diabetic client should be provided with a standard meal within 30 minutes from the time of lodging a complaint of missed delivery.

- **Measurement period** usually refers to the period of time over which the service availability, reliability, response time and resolution time will be recorded and reported. It should be noted that service availability, etc should be measured continuously throughout the measurement period

- **Responsibility for measurement** identifies the party responsible for measuring the performance (generally, the service provider)

- **Reporting frequency and method** varies according to the service. A high transaction-based service may require weekly reporting while a low transaction-based service may require monthly reporting. This is generally provided in some form of report, provision of data or exception report.

The information derived for each of the measurement categories will be documented in an SLA format, as illustrated at ***Appendix 5***. The actual format used will vary in the degree of complexity and details required, and by the nature of the service. Some SLAs may be expressed as a table of quantitative measures on a single page; others may run to many pages of description with qualitative and quantitative measures; and some may provide visual evidence standards for the service being outsourced. The issue is not the format but that the required service levels are adequately described so that the service provider and the department can objectively measure and monitor performance.

Further guidance on SLA development is provided in Section 9.3 of the User Guide to Contract Management.

2.3.3 Formulate the commercial arrangements

Commercial arrangements refer to aspects such as the contract size, contract duration, terms and conditions, pricing models and performance incentives that would affect the commercial viability of a contract. For a contract to be commercially viable, the commercial arrangements must be acceptable to both parties – offering value for money for the outsourcing department and reasonable profit for the service provider. It is advisable to collect market feedback on the proposed commercial arrangements and draw experience from similar projects.

Contract size and duration. Departments should determine the optimum scope of outsourcing from the point of view of both the department and the potential service providers. Surveys of departments and service providers have identified the loss of economy, efficiency and effectiveness in letting contracts that are too small and have short contract duration.

If contracts are of too short a duration, value for money may be compromised

The optimal length of the contract will vary subject to the type of service, risk profile and likely investment requirements for a service provider. In general, departments should avoid being locked into a high-risk arrangement for a long period. On the other hand, some departments have tended to be over-cautious. Three to five years are common contract periods and there are many instances where a longer period is appropriate. Typically, when the contract requires a more strategic level of involvement from the service provider, the length of the contract will be longer.

For example, a contract to outsource data processing may have a shorter term than a contract to outsource a strategic sourcing and procurement function. A data processing contract is transaction-based, which involves less system integration and capital investment. It will take less time for the service provider to achieve the targeted results. Conversely, a strategic sourcing and procurement contract will require considerable system integration, resource commitment and capital investment from the service provider.

For long-term contracts, departments may consider adding break clauses which will enable departments to exercise the rights for early contract termination under pre-determined conditions (e.g. agreed service levels not being fulfilled over a certain period). This arrangement will not only reduce the administrative costs arising from frequent contract renewals, but also provide strong incentive for contractors to deliver quality service throughout the contract period.

Pricing model. A pricing model represents the department's decisions on allocation of risks. A properly designed pricing model will provide strong incentives for a service provider to deliver good performance. There are four common pricing models (outlined below) that can be used in different circumstances. Depending on the nature of the outsourcing contract departments may use any one of or a mix of the models. Long-term contracts often include a price indexation clause based on published indices (e.g. Consumer Price Index) to ensure that unavoidable cost increases do not lead to deterioration in service.

Model	Applicability
Fixed price	
The provider is required to perform the work or services as specified in the contract for a fixed price (or lump sum) no matter what the actual cost is.	This model is typically used for straightforward contracts where the price for service delivery can be accurately determined, e.g. property management services for an office building. It is less suitable for those services that are subject to significant variations.
Payment for use or unit rate	
The service provider agrees to perform an estimated quantity of work for an agreed unit price. This is usually supplemented by a minimum quantity and an estimated total quantity to be ordered. Care needs to be taken that the service provider is not given responsibility for managing unreasonable demand risks that are outside of its control.	This model is generally used where the level of resources required, particularly labour effort, under the contract cannot be estimated with a reasonable degree of certainty in view of the fluctuating service demand, e.g. printing or courier services.
Cost reimbursement or cost plus	
The service provider is reimbursed for the cost of the resources incurred in providing the services (e.g. number of man-days taken, materials used) plus an agreed percentage or amount to cover the service provider's overheads.	This model can be useful when the actual work involved cannot be accurately estimated. It is often used when there is high risk and uncertainty associated with the costs and requirements of the service deliverables, e.g. large-scale maintenance services with different scope of work.
Performance-linked (also known as incentive payments)	
The service provider is remunerated for performance above that which can usually be achieved by the application of normal effort and skills in circumstances where this will add value to the outcome sought by the outsourcing department. The payment arrangement is usually determined by reference to formulae specified in the contract, such as key performance indicators. If the specified performance targets are not reached, the contractor forgoes part of the scheduled payment as specified in the contract.	Performance-linked payment may be used to encourage the achievement of desired outcomes exceeding a pre-set requirements, e.g. marketing and promotion services to raise venue utilisation or patronage.

2.4 Set transition and implementation requirements

Drawing up an outline of the transition and implementation requirements will assist both the tender selection process and the department's own transition planning. It will also assist the identification of issues that need to be addressed before tendering. The main elements for transition planning are listed below. Detailed guidance on transition planning is provided at ***Appendix 6***.

Matters to be considered in transition planning	
• Change management strategy • Implementation schedule for the new outsourcing arrangements and internal changes • Contingency plan for the transition • Contract management regime • Notification and process of handover • Asset disposal/transfer strategy	• Approval and audit processes • Expiry, termination and assignment plans for third party contracts • Staff redeployment to service provider or other departments • Service delivery monitoring mechanisms • Payment processes

The contract management regimes in cross-departmental outsourcing projects deserve special attention. In such projects, various departments may be involved in contract management. Broad divisions of work on different aspects of contract management work should be decided at the project planning stage. Consideration should also be given to set up a joint committee to oversee the contract management work and resolve any cross-departmental issues that may arise.

It is important to remember that any outsourcing contract has two transition periods: the transition-in, and the transition-out. Both aspects need to be considered carefully.

3 Tendering and Selection

Key Tasks

- Prepare detailed service acquisition plan
- Create tender documents
- Establish the evaluation process
- Approach tender boards
- Manage the tender process
- Evaluate tender responses
- Conduct due diligence checks
- Negotiate the contract
- Obtain clearance to finalise the contract

Having defined the scope of the service to be outsourced, the department can move into the phase of tendering and selection. The selection process will influence the working relationship between the department and its service provider. Fairness, merit and thoroughness are the precepts that guide this phase. The SPR set out the allowed actions in tendering and selection. This Guide has been prepared to fit within the SPR framework. It does not supplant the SPR and departments must familiarise themselves with the SPR before commencing tendering and selection. This chapter focuses primarily on the procurement procedures for major outsourcing contracts exceeding the financial limits specified in SPR 220. (For minor contracts, please refer to SPR 280-290.) Chapter 2 of the User Guide to Contract Management provides a list of outsourcing-related circulars and sources of advice. Departments should check the detailed requirements, ascertain whether there are any updates and seek advice from relevant departments where necessary. The selection and appointment of consultants is governed by separate procedures set out in Chapter IV of SPR.

3.1 Prepare detailed service acquisition plan

A detailed service acquisition plan should be developed, that is, how the department will go about securing a service provider. This plan should describe the various options and provide substantive reasons for a recommendation to proceed with the proposed tendering method. The Government has four ways of approaching the market through tenders. These are:

- **Open tendering**, where any interested service provider may choose to submit a tender
- **Selective tendering**, where registered service providers with the relevant qualifications are invited to submit their tenders. Selective tendering is usually adopted for works contracts
- **Pre-qualified tendering**, where tender invitations are sent by letter to those service providers whose pre-qualification has been approved on the advice of the relevant tender board

- **Single or restricted tendering**, where tender invitations are sent to only one or a small number of service providers approved by the Permanent Secretary for Financial Services and the Treasury (Treasury) or the Director of Government Logistics. This procedure is only used when circumstances do not permit open tendering (e.g. due to extreme urgency or security, or for proprietary products).

In addition to the selection of the tendering mechanism, the service acquisition plan should also include:

- The processes to be adopted in managing the tendering exercise
- A project plan to map out milestones, deliverables, resources and timing associated with the tendering and selection process.

To enhance the likelihood of receiving good quality bids, departments should be alert to the level of tender competition. Experience has shown that once bidders realise that the chance of winning the bid is slim, many of them would withdraw from the exercise to save their costs and efforts in responding. If many of those invited to bid do this it can result in too few bidders, and too little competition to the detriment of value for money. One way of addressing this is to seek tender boards' approval for short-listing/pre-qualification of tenders.

3.2 Create tender documents

Preparation of the tender documentation can be complex. It requires knowledge of both the service area and of contract preparation. But it should not often be necessary to start from scratch each time. Many departments have prior experience on which to draw. Some departments have adopted the standardisation of core contract terms and marking schemes, the alignment of service standards across contracts, bundling of contracts of a similar nature, and have set up departmental databases on outsourcing. In addition, the EU keeps sample tender documents that have adopted some outsourcing best practices. Departments are encouraged to make reference to these documents when drafting their own tender documents.

Appropriate standardisation of contract terms, service standards, and marking schemes may improve the efficiency of the procurement process

The key areas for preparation of tender documents are outlined below.

3.2.1 Document the service specifications

One of the most critical parts of a tender document is the service specifications, which usually includes the following:

- **Introduction** - sets out the objectives of the outsourcing exercise
- **Background information** - describes the environment in which the service provider will operate
- **Scope of services** - outlines the services to be delivered by the service provider
- **Roles and responsibilities** - sets out the roles and responsibilities of the service provider and the outsourcing department

- **Service requirements** - specifies in detail the services to be provided by the service provider, accompanied by performance measures and targets
- **Performance management** - sets out the reporting requirements and performance monitoring mechanism.

The mandatory and desirable elements of the service should be clearly stated in the service specifications so that service providers will know what provisions they must fulfil and where they may have discretion to add value.

3.2.2 Put together the tender documents

This step puts together the earlier work to form the documents for tender invitation. Tender documents must specify the rules under which the tender process will be conducted. Many Government departments adopt the common clauses, standard terms and conditions included in "GLD-Terms-2" in their tender documents. The GLD-Terms-2 is a reference document prepared by the Government Logistics Department (GLD) and is available from the GLD's Electronic Tendering System (ETS) web site (http://www.ets.com.hk).

To fully describe the department's requirements, it may be necessary to include additional requirements and contractual outcomes in the tender documents. This is best done in consultation with those with subject matter knowledge (e.g. operations, management, legal, etc.) and the stakeholders (e.g. the key end users and current internal service providers).

Tender documents and contracts should be cleared with the DoJ in accordance with SPR 345. Sufficient time (at least 21 working days) should be allowed, especially for complex contracts. It should also be noted that in many instances the clearance involves more than one exchange.

A typical tender documentation includes:

- **Lodging of tender** - sets out the tender closing date, location of tender box, etc.
- **Terms of tender** - the conditions that a tenderer has to observe when submitting a tender, the tender validity period, the currency to be used for the contract, etc.
- **Conditions of contract** - the conditions with which the contractor (and the outsourcing department) has to comply with in executing the contract. Departments may use the GLD's standard conditions of contract or draft their own conditions. In cases where departments choose the latter approach, it is unnecessary to make a distinction between general and special conditions of contract
- **Contract schedules** - sets out the various schedules for the tenderer to fill in and return
- **Service specifications** - sets out the services, requirements and specifications of the contract, e.g. service standards and performance measures
- **Offer to be bound** - to be signed and completed by the tenderer for agreeing to be bound by the terms of tender; and submitted with its tender
- **Articles of agreement** - contract between the Government and the contractor on the subject matter of the tender.

3.2.3 Draft the contract

Among the different components of a tender document, the articles of agreement, conditions of contract, service specifications and completed contract schedules usually serve as the basis of the draft contract which may be subject to negotiation. Upon agreement, these documents will be part of the final contract to be signed between the department and the successful tenderer.

The contract should be drafted taking account of the issues at ***Appendix 7***. Departments are also encouraged to refer to Chapter 7 of the User Guide to Contract Management in which the following guidelines with detailed explanations relating to contract drafting are provided:

- Develop relevant and concise service specifications
- Define appropriate terms and conditions
- Incorporate provision for variations.

Best practice reveals that good contracts have the following characteristics:

- **Contracts should be tight.** The foundation of a successful relationship is a well-designed contract. In a tight contract, both parties are clear about what the scope covers based on a comprehensive description of the required services and performance measures.
- **Contracts should be flexible.** Contracts should provide a mechanism to allow changing needs to be met. In a standard Government contract this is generally covered by a clause that allows for “options exercisable by the procuring entity”. From the department’s stand point, a long-term contract for services should not be too rigidly defined, as objectives, requirements, processes and technology are constantly changing.

  For example, flexibility encompasses the ability to easily handle more transactions up to a pre-agreed volume, change administrative arrangements, replicate the operation in an extra location, modify software or run on upgraded hardware.

- **Contracts should encourage, rather than penalise.** Contracts should be about encouraging good behaviour rather than triggering penalties.

  For example, a department pays its maintenance service provider 95% of the service fee under the contract if the system availability reaches the pre-set target of 95%. If the system availability exceeds the pre-set target, it pays an “extra” 1% of service fee for each percentage point of system availability exceeding 95%.

Organisations in both private and public sectors have demonstrated that good partnering relationships between contracting parties contributes to efficient and cost-effective service delivery. Therefore the inclusion of gains sharing may become more appropriate as the relationship matures. In doing this, the department needs a system that encourages desired behaviour whilst mitigating any risk of the service provider focussing on the incentives to the detriment of other areas. Before implementing a gains sharing or bonus system, departments should seek advice from the Financial Services and the Treasury Bureau (FSTB) and DoJ.

Some departments seek to impose in the contracts financial penalties for a breach of contract. A penalty imposed under a contract is not enforceable and the defaulting party has no liability to pay the agreed sum.

Where a contractual provision specifies the amount of compensation payable by a defaulting party to the innocent party, the courts are only prepared to enforce it if the provision is a genuine pre-estimate of damage. The question whether a sum stipulated is a penalty or liquidated damages is a question to be decided based on the terms and inherent circumstances of each particular contract, judged at the time of making the contract, not at the time of the breach.

- Contracts should guard against non-performance. Departments should set out appropriate clauses in their contracts so that they can take effective actions against non-performing contractors without resorting to contract termination. These actions may include withholding of payment or incentives and step-in.

3.3 Establish the evaluation process

A properly designed tender evaluation process can help select a contractor that is capable of delivering services up to the outsourcing department's expectations. For contract renewals, it is a good practice to review the effectiveness of the past marking scheme.

The tender assessment panel. The panel should comprise at least two Government officials, typically including technical/operational, business, financial and senior management representatives. It is a good practice that key stakeholders are also represented in the panel. To enhance independence, departments may consider appointing Government officer(s) external to the department on the panel.

The marking scheme. A marking scheme provides a rigorous and defensible approach for assessment of the relative merits of individual tenderers. Unless prior approval has been obtained, marking schemes must be submitted to the relevant tender board for approval before the tender is issued.

The use of a marking scheme generally requires separate evaluation of price and technical criteria, known in the civil service as the "two-envelope" system. The evaluation criteria can be developed by reference to the service specifications.

Opinion surveys of contractors suggest that there may not always be sufficient transparency in the selection process and that there can be an overemphasis on price to the detriment of recognising the importance of contractor's past performance.

Care must be taken to ensure that the marking scheme, particularly those with a high price to technical ratio, will not result in the selection of low quality tenderers with the potential risks of unsatisfactory performance and/or labour exploitation. Departments should give sufficient weighting to technical/quality requirements to reflect the nature and complexity of the services to be outsourced. They can also consider setting relevant mandatory requirements and passing marks under the marking scheme. Since non-compliance with the mandatory and/or passing mark requirements will render a tender disqualified, departments should make sure that such requirements are absolutely essential and be kept to the minimum to allow more competition.

Consideration should be given to assign appropriate weighting to the tenderers' past performance on a department's contracts (or other contracts of similar nature). By doing so, a department can have a better chance of selecting contractors with proven track records. It also provides a strong incentive in future for contractors to perform better since good performance will be rewarded with better business opportunities.

Contractors have expressed the view that insufficient weighting of past performance in tender evaluation has been a demotivating factor in preparing quality tenders.

For new tenderers that have no proven track records with the Government, departments might consider sending standard questionnaires to the tenderers' referees direct in order to obtain comprehensive information on the respective tenderers' past performance. Such comprehensive information can ensure all new, existing or former tenderers' past performance are taken into account.

Appendix III (G) of the SPR provides guidelines for adopting a marking scheme for tender evaluation.

Technical evaluation. Consideration should be given to the weighting of the evaluation criteria, and use of an appropriate marking scheme. In designing a marking scheme, the following issues should be considered:

- The use of a manageable number of evaluation criteria
- Classification of evaluation criteria into mandatory and desirable
- The overall pass mark and minimum marks under each category of criteria (if any)
- The use of objective and measurable evaluation criteria for rating
- Weighting of individual criteria in respective of their relative importance
- Transparency and clarity of the marking scheme
- Effectiveness of the scheme to differentiate and rank the qualitative competitive edge of compliant bids.

After the technical evaluation criteria are identified, they are classified between mandatory and desirable (value added) criteria. The table below illustrates such a division.

Examples of evaluation criteria

Mandatory criteria	Desirable criteria
The service provider must have at least ten years of continuous proven experience in the operations and maintenance of equivalent or similar telecommunications equipment	The service provider should preferably possess a valid ISO 9001:2000 accreditation certificate or equivalent internationally recognised quality standard accreditation certificate on the provision of services for telecommunications facilities
The call centre must be physically located in the urban area or any place which is within 20 minutes walking distance from any mass transit railway station	The location of the call centre can be conveniently accessed by mass public transport

Departments shall observe the guidelines promulgated in Financial Circulars No. 3/2004, No. 5/2004 and No. 4/2006 (as may be updated from time to time) when setting mandatory requirements in the marking schemes for the assessment of tenders for those service contracts that rely heavily on the deployment of non-skilled workers.

In the past few years, the Government introduced a number of measures to protect the rights and benefits of non-skilled workers engaged in government service contracts. Key measures on evaluation of tenders for service contracts (excluding construction service contracts) that rely heavily on the deployment of non-skilled workers include the following:

(a) **Mandatory requirements for tender assessment.** Financial Circular No. 3/2004 of March 2004 stipulates a mandatory requirement on past conviction records and demerit points (see also item (c) below);

(b) **Committed wage level.** Financial Circular No. 5/2004 of May 2004 stipulates a mandatory requirement on wage level for non-skilled workers;

(c) **Tightened measures on management of service contractors.** Financial Circular No. 4/2006 of April 2006 promulgates tightened measures, including:

(i) if a tenderer has obtained any employment-related conviction on or after 1 May 2006, his tender will not be considered for a period of five years from the date of conviction; and

(ii) if a contractor has, over a rolling period of 36 months immediately preceding the month of the tender closing date, accumulated three demerit points (under the Demerit Point System) obtained on or after 1 May 2006, his tender will not be considered for a period of five years from the date the third demerit point is obtained.

Financial evaluation. The department should develop a financial assessment model to assist it in the collection and assessment of the financial elements of the tenderers' submissions. It should specify all relevant categories of costs to be submitted by the tenderers so that the tender assessment panel can compare the price proposals.

For large-scale projects, a department may consider comparing the cost of outsourcing against the benchmark cost of in-house delivery to ascertain if the price proposals are value for money.

Estimate the external and internal costs of outsourcing. Both the service provider costs and department costs should be taken into account:

- **Service provider costs**
  - Contract price (and cost elements)
  - Incentives/rewards to the service provider for superior performance as specified in the tender specification.
- **Department costs**
  - Contract management costs, including costs for contract management staff and related training and development
  - Transition costs, including costs to be incurred for handing over the delivery of the service to the new service provider
  - Contract termination cost.

Benchmark costs. Whether tendering an existing outsourced service or a service to be outsourced for the first time, a department should have available estimates of the current costs of the service for benchmarking. This data will be compared against the costs of any tenders to assess the reasonableness of the bid prices and the viability of the outsourcing. It should be noted that, depending on the outsourcing objectives, the benchmark cost should not be the sole criterion for determination of the viability of outsourcing.

The benchmark costs should include both direct and indirect costs.

- **Direct costs**
  - Current operational costs (including total employment costs, materials, utilities, servicing of equipment, site and ancillary services such as security, cleaning, courier services and specialist printing) together with an estimate of the likely additional costs if the required scope of the service is greater than the current scope or there are changes to the service levels
  - Hardware, software and equipment used in providing the service
  - Capital used exclusively for the service.
- **Indirect costs**
  - Services provided by other departments but not charged for
  - Capital and equipment that is not used exclusively for the provision of a service (calculate a proportionate share attributable to the service)
  - Overheads that are spread across the whole department (calculate a proportionate share attributable to the service)
  - Cost of tendering the service, e.g. cost of engaging external advisers.

Recurrent costs will of course need to be projected forward over the term of the outsourcing contract. In making the forward estimate of the cost of delivering the current service the department will need to consider if the service is one in which service levels and/or technology are likely to undergo considerable change over the period under consideration. The costs of any technology and equipment upgrades, changes in the provisions of service levels, or changes in the terms and conditions of staff delivering the service (i.e. salary increases or other benefit changes) need to be factored into the forward projection. The use of sensitivity analysis to show the impact of possible cost or service changes is a useful tool.

In estimating contract management costs the department will have to consider how the staffing of the contract management function will be achieved. This will include all staff required to manage the contract and to monitor the service delivery during the contract term. This may be achieved through redeployment of existing staff of the department or may require recruitment of additional and specialised staff if outsourcing represents a significant expansion of the existing service.

In order to ensure a fair comparison between the cost of outsourcing and the cost of in-house provision, where applicable, the effects of other relevant factors (e.g. taxation, regulatory requirements) should be taken into account.

> For example, in a contract involving the costs of motor vehicles, an outsourcing contractor would be subject to a range of related taxes from which departments are exempt.

3.4 Approach tender boards

For tenders/contracts exceeding the financial limits specified in SPR 220, departments need to seek approval from different tender boards, before invitation or acceptance of tenders. The major tender boards and their key approval authorities are:

Major tender board	General approval authority
Central Tender Board (CTB) deals with high value tenders which exceed those values specified for the subsidiary tender boards. Tenders for goods and general services exceeding $10 million and tenders for construction services exceeding $30 million are considered by CTB.	• Use of marking scheme • Acceptance of tender • Cancellation of tender exercise • Tender negotiation
Government Logistics Department Tender Board deals with tenders, including revenue tenders, of a value exceeding $1.3 million and not exceeding $10 million, except those tenders dealt with by other subsidiary tender boards.	• Use of marking scheme • Acceptance of tender • Cancellation of tender exercise • Tender negotiation

Up-to-date information on the membership, terms of reference and financial limits of the tender boards is published in the Civil and Miscellaneous Lists at http://www.info.gov.hk/cml/eng/cbc/c23.htm.

3.5 Manage the tender process

The department will generally advertise an outsourcing project through an ITT. When the range of potential solutions cannot be readily ascertained or the service provider market is not well known, the ITT may be preceded by engaging the market (See Section 2.3.1 above).

Establish the tender framework. The following best practice principles should be followed throughout the process:

Openness, transparency and ethical dealings are the hallmarks of a good tender process

- **Keep the process transparent and open.**

  For example, note and file all relevant communications and ensure all potential tenderers have equal access to the same information. Where one prospective tenderer seeks and is provided with additional information it should be made available to all tenderers.

- **Minimise opportunities for unethical behaviour.**

  For example, channel all communications through an adequately supervised designated officer.

- **Design an unbiased, competitive and anti-monopolistic process.** To limit the opportunity or appearance of bias, the identity of tenderers may be withheld from the tender assessment panel. Nonetheless, all panel members will need to declare any possible conflicts of interest.

The tender process should not create obstacles to international trade or to competition amongst the potential tenderers. Departments need to guard against over-reliance on a few dominant contractors as their under- or non-performance could lead to significant service disruptions.

- **Maintain appropriate confidentiality of tender submissions.** It is important to be aware that some of the information, submitted by tenderers, constitutes their intellectual property as a trade secret; without the tenderer's prior approval it cannot be used by the department unless the terms of the tender express otherwise. If departments are in any doubt concerning intellectual property rights embodied in tenders they should consult the Intellectual Property Department.

Finalise the list of tenderers and make the tender documents available. Once the tender documents are finalised, the department needs to make them available in accordance with the service acquisition plan (see Section 3.1) and in accordance with the SPR 340. Where the department physically provides hard copies of the tender documentation to tenderers it should check that the documents have been received. If the tender is issued electronically this receipt process is not required. Where tender documentation is issued electronically the department should request contact information from all organisations downloading the documentation in order to provide follow-up information as necessary.

Conduct a briefing for tenderers. If the department intends to hold a briefing for tenderers, this should be mentioned in the ITT, identifying time and location. The briefing would normally be held soon after the ITT was issued. Issues typically covered in a tender briefing session include:

- Scope and scale of services to be outsourced
- Current volumes and operational statistics
- Service and technical requirements
- Transfer or sale of asset
- Staffing issues
- Performance measurement
- Tender evaluation process.

The briefing session is an opportunity for potential bidders to obtain clarification of the contents of the tender documents. If considered useful, departments should also arrange site visits for tenderers so that they could be more aware of the department's service requirements, the physical working conditions, the conditions of assets to be maintained, etc., when preparing their proposals.

Allow sufficient time for tender submission. Departments should ensure that tenderers have adequate time to prepare a quality submission. Where outsourcing contracts are large and commit the parties to a long-term relationship, a longer tender submission period is preferred. The generally applied minimum in the civil service is three weeks while at least 40 days is required for contracts covered by the World Trade Organization Agreement on Government Procurement (WTO GPA).

The department should issue a receipt to tenderers when submissions are received. The closing date and time should be strictly adhered to; and unsolicited revisions to submissions received after the closing date and time should not be accepted.

3.6 Evaluate tender responses

The evaluation of an outsourcing tender can be broken up into two main steps:

- **Technical.** The department evaluates the technical/operational aspects based on the criteria drawn up and issued with the tender. It also compares the tenderers' responses to the tender invitation to determine the viability of entering into an acceptable contract with the tenderer.
- **Financial.** The department compares the prices submitted with the current costs of the service. The analysis should be kept separate from the technical/operational evaluation, to prevent bias based on price.

The ultimate aim of the evaluation process is to select the most appropriate service provider to manage and deliver the service. Value for money is important in selection. Awarding a contract to a provider that offers an unreasonably low price could result in low quality service and incur excessive supervision effort. A system using the combined technical and financial scores may produce a higher score for a tender that is not offering the lowest price. Nonetheless, the contract should be awarded to the highest scoring tender. For this reason, the marking scheme chosen should accurately reflect the relative importance of price and quality in the selection criteria.

Evaluate tender compliance. Prior to a detailed evaluation, the department may need to produce a list of conforming tenderers, i.e. tenderers who fully conform to the mandatory requirements and comply with the tender process. Nevertheless, the department should make all reasonable efforts not to exclude viable service providers.

> For example, when a section of the response has not been received and this may be an administrative oversight rather than an inability to provide the service, departments should consider the significance of the omission and, subject to the terms of the tender, allow the administrative and process errors to be corrected. However, this should not be used to allow tenderers to change their tender.

Generally, if none of the tenders is complying, departments should seek the relevant tender board's approval for cancelling the tender process (SPR 380 (e)). Where necessary, it should re-tender with revised specifications, terms and conditions, etc. However, if a department decides to proceed with a non-conforming tender this is allowed for in the SPR 370 (g) and the tender report must clearly specify what deviations exist and the reasons for proceeding with the tender despite this.

Evaluate tenders in detail. Following the compliance evaluation, the department will evaluate the tenderers using the evaluation model set up prior to issuing the tender. If using the two-envelope process departments should evaluate the technical envelope first.

Do not open price envelope until technical evaluation has been completed

- Operational/technical outcome. Rate the responses submitted against the predetermined criteria and, if using a marking scheme, provide a score for each.

> Sometimes it would be beneficial to have tenderers present their proposals to the tender assessment panel, introduce their management teams and clarify issues. If the department plans to do so, it should set out the requirement in the tender document. It should normally invite all conforming tenderers for presentation. Such presentations should be limited to clarification rather than allowing the tenderers a second chance to beef up their proposals.

Depending on the technical evaluation criteria, site visits may also help the tender assessment panel assess intangible issues such as values and organisational compatibility between the department and the tenderers; and the qualities of the staff actually doing the work and their supervisors, as well as the tenderers' senior management and support teams.

- **Price Outcome.** This covers the tender price of the tenderer - the price envelopes should be opened only after completion of the technical evaluation.

  First make an assessment of the relative prices of the tenderers. Input the prices submitted into the financial assessment model and perform a comparison with the benchmark costs. This will provide a score for each. Use of a financial assessment model will help the department make an assessment about the reliability and relative value of pricing information that may be presented by tenderers in different ways.

Copy correspondence to one tenderer to all tenderers

During the evaluation process there may be cases where the tender assessment panel requires the clarification of information relating to a tender. If any panel member identifies a need for clarification then that person should document this need, including the reasons and the potential effect on other tenderers. A clarification notice must then be forwarded to the tenderer in writing and must set a reasonable time frame for provision of an answer. The response should be in writing and within the specified time.

Conduct financial vetting of tenderers. The purpose of financial vetting is to confirm that the tenderer has sufficient resources to satisfy the department's needs and will provide the necessary insurance and indemnities that the department will require in order to enter into the contract. Financial vetting is generally conducted on the tenderer who is being considered for the award of a service contract. It occurs at this time as it is one of the last points in the formal evaluation process to confirm whether the tenderers are capable of fulfilling the contract requirements. This is mandatory for any service contracts in excess of limits set in SPR 370 (b) (i). Departments should refer to Appendix III (H) of the SPR and the Financial Vetting Guidelines issued by the Treasury (available from the Treasury Intranet in the CCGO website) for the detailed guidelines for conducting financial vetting. For a tenderer to pass the financial vetting, it must be able to satisfy the requirements of three critical financial criteria, i.e. profitability, working capital, and employed capital.

For a long-term outsourcing contract that lasts for a number of years, the financial position of the contractor could change over time and it may become financially incapable of fulfilling the requirements of the contract. Departments should address this risk by considering including a clause in the contract whereby a contractor will be subject to periodic financial vetting; and based on the vetting results take appropriate actions (e.g. requesting an additional bank guarantee, or terminating the contract).

Select recommended tender. Finally, all elements of the evaluation criteria are taken into account to determine a list of recommended tenderers in order of merit. If a marking scheme is being used the raw and weighted scores would be finalised at this point.

The preferred service provider should now be apparent and a report on the tendering process is prepared for the department's senior management and the relevant tender board that addresses the following:

- The scope of services to be outsourced
- Market reaction to and interest in the project

- Anticipated costs
- Cost/benefit and risk assessment
- Ranking of all conforming tenderers
- A recommended tenderer or a recommendation to negotiate the terms of the contract with one or more of conforming tenderers (See Section 3.8 below).

Appendix III (I) of the SPR provides a template for preparation of a recommendation to the relevant tender board.

3.7 Conduct due diligence checks

A due diligence check goes into greater depth than the financial vetting during the tender evaluation. This is an opportunity for both the department and the service provider to thoroughly examine the viability of entering into a contractual relationship.

The due diligence will vary for each outsourcing contract. Put simply:

- The department is assuring itself that the potential service provider has the capacity, capability and assets it claims to have
- The service provider is making sure it fully understands what is required and that it is capable of delivering in accordance with the terms specified in the contract.

Conduct due diligence review of the service provider. The department will need to conduct an audit on the service provider's premises, equipment and key personnel to check the reliability of a service provider's statements in regard to its ability to meet the terms of the contract.

In general, the department will:

- Confirm the credentials of the service provider and its key staff, including referee checks
- Confirm the financial position of the service provider
- Obtain any bank or corporate guarantees required under the contract

  > Departments should ensure, where applicable, that the contract deposits are settled and the insurance policies have been taken out (which should normally be in the joint names of the Government and the service provider) prior to the contract commencement or renewal.

- View any required documentation, e.g. insurance policies, quality assurance accreditation. Where necessary, departments may include a provision in the contract to require the contractor to furnish copies of the required documentation for checking and retention and provide new copies upon expiry of the existing ones
- Identify and resolve any intellectual property arrangements
- Review the physical or intellectual property assets promised by the service provider for the delivery of the service
- Conduct final review of the impact of ordinances/regulations, policies and administrative arrangements relating to the service

- Review the service provider's proposed approach to carrying out the procedures including any quality management or accreditation system (e.g. ISO 9000), technical or operational documentation, if necessary
- Review the service provider's procedures on ethical business practices, and confirm the existence and quality of its company code of ethics and staff code of conduct

> For example, the company code of ethics and staff code of conduct should cover acceptance of advantages and entertainment; declarations and avoidance of conflict of interest; and non-disclosure of confidential information

Departments should note that staff of the private sector service provider are performing a public duty in the delivery/discharge of the outsourced government service/function. They should observe the stringent ethical requirements of a Government servant. Service providers should, therefore, be required to compile a staff code of conduct governing, inter alia, acceptance of advantages, declaration and avoidance of conflict of interest, etc., for compliance by their staff

- Review any taxation matters that may be applicable
- Review any regulatory requirements that may be applicable.

Other useful information that will assist in assessing the service provider's viability includes:

- Company structure and shareholdings
- Past or present legal actions against the service provider
- Past performance on government tenders.

Facilitate due diligence review by the service provider. The service provider will probably wish to:

- Determine that the performance levels set by the department are realistic and achievable
- Perform an asset audit in cases where departmental assets are to be transferred to the service provider. This should include a statement of the condition of each asset and its location, and an asset disposal strategy if required
- Confirm the credentials and identify the department's key staff (in particular, contract management staff)
- Review the inventory of all existing contracts, leases and licences and ensure that all third parties have been advised of the new service arrangements by the department
- Clarify arrangements for operational interaction between the service provider and the department at a variety of levels, and with clients and other stakeholders as appropriate.

3.8 Negotiate the contract

In general, it is the Government's policy to procure services on the basis of competitive tendering, with the contract being awarded to the tenderer that conforms with the tender specifications and offers the most advantageous terms to the Government. Where certain terms and conditions of the tenderers' offers are considered not in the Government's best interest, departments may seek approval from the relevant authority to negotiate with a tenderer or tenderers (see SPR 385). The scope of negotiation in all circumstances is confined by the requirements specified in the tender specifications. Some common areas of negotiation are: a reduction of tender price (if it is considered not in line with the prevailing market rate); a change to the payment terms; removal of a counter-proposal (e.g. restriction of liability) from the tenderer; or adjustment to the price for additional services.

The department will need approval from the Permanent Secretary for Financial Services and the Treasury (Treasury) or other parties (relevant tender boards, Director of Government Logistics and Controlling Officer) to which he has delegated authority to begin negotiations on the contract and finalise the contract provisions. Departments should note that negotiations shall be conducted in a non-discriminatory manner between different tenderers. The right of the department to negotiate will have been stated to the tenderers in the tender documentation. If the tenders are governed by the WTO GPA, departments must also observe its relevant provisions (including Article XIV).

Appendix 8 sets out the processes related to contract negotiation.

3.9 Obtain clearance to finalise the contract

The department will need to obtain the relevant tender board's approval for the final tender recommendation. It should develop a final submission summarising the reasons for recommending the service provider, assessing the degree of risk in entering into this arrangement and confirming that the contract represents value for money. Appendix III (I) of the SPR provides a standard tender report format for departments to use.

The contract shall be signed on behalf of the Government by an officer at directorate level unless the FSTB has authorised otherwise, as per SPR 505 (e). After the contract is signed, the unsuccessful tenderers must be formally notified in writing. Requested debriefings should be given for contracts covered by the WTO GPA.

4 Contract Management

Key Tasks

- Implement the transition plan
- Manage the relationship
- Monitor service delivery
- Monitor benefits achieved
- Administer the contract

Contract management is the process that ensures both contracting parties meet their obligations in order to deliver the objectives required from the contract. From the department's perspective, the key focus of contract management is to obtain the services as agreed in the contract and achieve value for money. Although the contract management process begins with contract transition, the foundations for good contract management are laid during the pre-contract processes which determine the roles and responsibilities between contracting parties, service requirements, performance measurement, tender selection criteria, etc.

4.1 Implement the transition plan

In the transition stage, the contract is subject to a number of criteria being fulfilled. These will generally include confirming transition plans, confirming financial arrangements and payment of contract deposits or submission of performance bonds. The department should, subject to the conditions of the contract, require the contractor to submit applications for appointment of sub-contractors for approval. It should also set up the arrangements for monitoring and administering the contract. ***Appendix 6*** provides more information on transition planning. Further guidance is provided in Chapter 14 of the User Guide to Contract Management.

Finalise the transition plan. This stage covers the transition to the selected service provider. Timetables, responsibilities and deadlines for the transition should be finalised.

Broadly, the transition plan covers transition for department staff to new roles if any, establishing mechanisms to monitor service delivery, transfer of assets where applicable, and phase-in of the new service provider. It will also cover the management of the risks that will be faced at the point of service commencement by the new service provider. A contingency plan needs to be in place in the event of any service failure during and after the handover.

The final transition plan should include matters as discussed in Section 2.4 Set transition and implementation requirements.

The formal handover may take some time to phase in after the contract is signed and transition begins. This might be the case where the outsourced service is to be provided over a wide geographical area and/or requires a large amount of information to be exchanged.

Post implementation review may be conducted at the end of the transition period. This would be particularly helpful if the department plans to transfer the experience and lessons learnt when outsourcing other functions.

Move staff to new arrangements. Resolving issues relating to existing staff affected by the outsourcing and/or any new staff required to take up the contract management function is an important part of the broader transition to the outsourcing arrangements.

Planning for this activity will have commenced in the preparatory stage. Human resources issues may now take priority as the manner in which redeployment and transition of staff are handled can affect the morale of the entire organisation.

Staff transition issues include:

- Planning to phase down departmental staff in anticipation of the service to be outsourced
- Finalisation of organisational arrangements for, and staffing of, any functions retained by the department or associated with outsourcing the service
- Establishment of the ongoing contract management function that is to be adopted (including any recruitment of specialist skills)
- Staff redeployment, secondment, and training.

Set up the contract management regime. The department should have determined who will be responsible for the contract management at a senior level and the size and form of the team that will support this role. ***Appendix 3*** provides further information on the key roles required in contract management.

There is no formula for deriving the number of staff required to support contract management. International comparisons indicate that best practice in contract management resourcing averages at approximately 3% of the contract price. This is not a hard and fast rule. Contract management arrangements (and costs) will depend on the size and complexity of the contract(s) to be managed and whether the department manages all contracts through a centralised contract management unit or by individually designated staff on a contract-by-contract basis.

The department should also establish the associated systems and procedures for contract management. These normally include the following:

- Performance monitoring system, e.g. guidelines for performance inspections, performance assessment and taking enforcement actions against defaulting contractors. All performance monitoring actions should be properly documented. An internal monitoring system should be established to ensure that the performance monitoring actions are conducted in accordance with the established guidelines and procedures
- Contract administration system, e.g. procedures for payment procedures, change control such as contract variation, and contract extension. Training should be provided to the contract management staff.

Transfer assets and third party contracts. Any requirement for the transfer of assets and/or third party contracts as part of outsourcing should have been thoroughly considered during the preparatory stage and subsequent preparation of the tender documentation.

4.2 Manage the relationship

Management of the relationship between the parties affected by the outsourcing contract is crucial. Departments should resource this appropriately to ensure success.

The three key parties to any outsourcing are:

- **Department.** Its primary responsibility is to monitor whether the service provider delivers the outputs and outcomes in accordance with the contract. The department does not become involved in the daily operational issues unless the delivery of the service is threatened. The department also manages the expectations of users and collects their feedback on how the services are performed.
- **Service provider.** Its primary responsibility is to fulfil its contractual obligations by delivering the service to the users in accordance with the contract. As a secondary responsibility, the service provider must report on its service delivery to the department. This reporting aids both parties in continually re-examining the success and viability of the outsourcing relationship.
- **Users.** If the users of the service are government staff, their responsibility is to use the service so as to generate or add value to their department's operations. As a secondary responsibility, they should provide feedback and communicate issues to both the service provider and the department's contract managers. Where the users are members of the public or the business community the department should establish mechanisms for seeking user feedback on the service delivery.

All three parties should manage their responsibilities following best practice principles for the outsourcing contract to be successful. These include:

- **Promoting the change.** The service provider and the department must work together to communicate the nature of the change and the services available to government staff and/or the community.

  For example, the department needs to communicate the agreed service level standards to the users so that they understand the limits of the department's relationship with the service provider and what they as users can expect.

- **Managing expectations.** To avoid any dispute that may arise during the contract period, both the service provider and the department must manage each other's expectations. The department must explain to the service provider how the department works and how to work effectively within its environment. The service provider on the other hand must reveal to the department how it is going to meet the contract's requirements. Both parties should work out an arrangement that is conducive to the operations of both parties within the scope allowed for in the contract requirements.

  For example, the service provider should know the likely turnaround time to obtain approval from senior management of the department so that it may manage its own supply chain and resources effectively.

  If the department manages the service provider's expectations properly the relationship between the parties will be preserved and the service provider will be able to manage the supply of the service more effectively.

- **Knowing the business.** The service provider must know the department's business and future strategy for the outsourced service. It must understand exactly what the department wants and needs.
- **Communicating user needs.** The users and the department must let the service provider know - formally or informally - their needs and any issues that come up.
- **Keeping to defined roles.** The department should not be involved in the day-to-day delivery of the service. Under an outsourcing contract, its role is to manage the service delivery relationship, not the services themselves. It should become involved only when service standards are not achieved or are threatened.

  Correspondingly, the service provider should act within the scope of its service specifications. Any change in the scope of its role must be through formally managed contract variations. Otherwise, the service provider may find itself performing tasks outside its scope for no recompense, which may adversely affect its ability to deliver the services originally contracted. Formal contract variation is required even for those instances where the parties agree informally to substitute different activities for the same contract price. Remember, many outsourcing contracts are long term and contractor or departmental staff who make informal agreements may not be there for the life of the contract.
- **Achieving and maintaining a partnership.** While a well-drafted contract lays the foundation for success, it is no substitute for maintaining a partnering relationship between the contracting parties. The objective of a partnering relationship is to ensure that both parties work towards the common goal of achieving the contract outcomes. It is in the department's own interests to make the partnership works. If the relationship is not well maintained, it is likely that both parties are distracted from achieving the desired outcomes and spend time and energy in unproductive arguments and exchanges, or worse.

  The key factors for achieving a successful partnership include:

  - Mutual trust and commitment
  - Openness and frank communications
  - A joint approach to managing delivery.

> For example, one department has established a number of communication channels with its contractors such as: annual tea gatherings of the top management of major contractors; tripartite meetings between the headquarters contract management team, district/venue managers and contractor management, covering both current contracts and tender assessment and outsourcing arrangements in general; and venue managers are encouraged to provide direct, positive and negative feedback to contractor management.
>
> Under such arrangements, both the department and its contractors can better appreciate each other's concerns and expectations; and they can work together to resolve issues. Through candid exchanges of views, major issues can be brought to the direct attention of senior management of both parties, and improvement opportunities can be readily identified. The department considers that its contractors behaved and performed better after the introduction of the arrangements.

Further guidance on maintaining contractor relationships can be found in Chapter 10 of the User Guide to Contract Management.

Maintaining the effectiveness of such contacts requires effort and diligence. The 2006 Outsourcing Survey results revealed that whilst a good proportion of contractors found meetings with departmental contract managers, senior management and frontline staff useful, the majority were less than satisfied with existing contacts with departments; and over half of contractors complained of insufficient opportunity to meet departments' senior management.

It should be emphasised that maintaining a partnership with a service provider does not mean not enforcing the contract terms when it is warranted.

- **Processing of payments must be accurate, timely and auditable.** The service provider must produce accurate reporting that meets the department's needs. All invoices must be accurate, clear and auditable. The department should provide sufficient resources to audit and process invoices promptly.
- **Innovating and improving.** The parties should work together to innovate and continuously improve the service quality, and to find more effective ways to satisfy user needs. Many contractors appear keen to be given flexibility in choosing the method by which they provide a service.
- **Good faith.** An outsourcing contract requires considerable commitment in resources and time to work effectively. Both parties need to enforce the contracted terms of the relationship diplomatically. The parties need to keep in mind that a possible disengagement from a contract is costly and may involve damaging publicity.

4.3 Monitor service delivery

Monitoring service delivery is vital to successful contract management. Data derived from the monitoring process will be used by the department to determine whether there are any issues to be addressed; to grant contracted rewards to the service provider for exceeding service levels; to take remedial action for under-performance, and also help the department decide its future action when the contract finishes.

Successful outsourcing requires rigorous contract monitoring

Performance monitoring. When providing a service, the service provider is best placed to collect data for reporting its service delivery to the department. Departments should consider that service delivery is to be self assessed by the service providers, supplemented by sample checking and/or physical spot checks by the department, and a mechanism to monitor complaints and feedback from the users and the public. Departments can also consider requiring the service providers to appoint independent parties to conduct the assessment and to report directly to the departments.

Where departmental staff are deployed to monitor and inspect the performance of the contractors, departments should ensure that the scope and extent of inspections are clearly laid out and followed by responsible staff in practice. Where similar contracts are let in different districts, consistent approaches should be followed. If sub-contractors are involved, their performance should also be monitored. Also, inspections should be conducted using a risk management approach in the light of complaints received, contractors' operating hours and past performance records. Special attention should be paid to the performance of dominant contractors. For contracts let out on a geographical basis, consideration should be given to the sharing of performance information of contractors among district offices. Inspection records and enforceable actions taken should be properly documented.

The performance assessment should be built into the formal reporting requirement of the contract; departments should guard against demanding an excessive level of reporting as it will inflate the contracted cost and distract the service provider from delivering the services to end users.

User satisfaction may be one of the key measures for determining performance in the delivery of the contract. If it is part of the formal reporting measures in the SLA, a sound methodology must be agreed before the contract is finalised. This may range from simple measures such as the number of complaints registered to a more formal survey involving a statistically valid sample of users. If user satisfaction is not a required performance measure the department may use less formal measures to get user feedback. Whatever method is used, a baseline level of user satisfaction prior to the transfer of the service should be established to provide valid comparisons.

During the transition period the department should test the effectiveness of the arrangements it has put in place for monitoring service delivery. Some issues to be considered at this time include:

- The form and detail of reports
- The frequency of reporting
- Ensuring the department receives the right information to exercise its ongoing accountability for the service.

The reporting frequency for contract monitoring purposes varies. A service with high transactions, e.g. an e-procurement portal, may require weekly reports while one with low transactions, e.g. property management outsourcing, may only require monthly reports.

Reporting frequencies may also vary with the stage of the outsourcing relationship. During the transition stage, daily or weekly reports are advisable. Once the implementation phase is satisfactorily completed, the department does not need to monitor the progress so closely.

The department must analyse the service level compliance reports provided by the service provider against the agreed service levels in the contract. This must be done with every report submitted. Every non-performance issue should be recorded, reported appropriately and resolved quickly.

In addition, opportunities for improvement to the performance of the contract should be recorded and presented for discussion between the service provider and the department. The discussion can be held during review meetings for monitoring contract performance or during less formal contacts between the contractor management and the department.

Quality assurance. The department should hold formal and regular review meetings with the contractor at a senior level. These may be held as regularly as necessary. Quarterly or half yearly is often the case. Review meetings should:

- Review the strategy and plans
- Assess actual performance against agreed service levels and against the findings of the review conducted before deciding whether to renew the outsourcing contract (see Section 2.2)
- Conduct benchmark reviews against other similar arrangements, using actual performance data
- Endorse requests for any contract variations
- Approve budget projections.

In addition to this senior level review, a team at the operational level will need to monitor the contract more closely. The frequency and agenda of their review meetings will change throughout the life of the contract. This may be several times a week throughout the transition and initial operational stages. Afterwards, it may meet weekly, fortnightly or monthly to address issues as they arise. The review meetings should look for improvement opportunities and identify any additional or unnecessary requirements.

Regular independent reviews of quality should be conducted on the service provider. The purpose is to ensure that the results reported by the service provider are accurate and can be relied upon. It is an independent check in the performance monitoring process and should tie in with any performance reporting. In addition, the department should confirm that any other contractual requirements are being satisfied.

The reviews, generally conducted by internal audit staff and key internal customers, may be held every six months, with a formal report issued prior to a review meeting with the service provider. The frequency of the review will depend on the size of the contract, the risks of non-compliance, the track record of the service provider and the development of the working relationship between the department and the service provider.

Under-performance. If the service is not delivered in accordance with agreed service levels, the immediate step will be to resolve the issues directly with the service provider.

As a general rule, if the department is unhappy with the performance of the service provider it should raise the issue as early as possible. Both parties to the contract should work together to raise the service to the expected level or to resolve any misunderstanding or over-expectation. If a service problem exists, it is common for an agreed action plan addressing the problems to be prepared and for the service provider to commit to measurable improvements within a specified period of time.

Depending on the seriousness of the under-performance, the department may refer to measures set out in the contract for under- or non-performance of service, such as:

- Withholding incentives or issue of default notices
- Involving senior management from both parties in formal discussion or written communications
- Resolving unsettled disputes through conciliation/mediation or arbitration.

As a last resort, the parties may need to consider disengaging from the outsourcing relationship. It will take much time, expense and senior management involvement to disengage from the contract. Therefore, in deciding what action to take, the department must consider the effect on the relationship between the parties. Outside advisers can be very valuable as independent mediators. The example below illustrates a commonly used dispute escalation process.

The department and the service provider agree to work jointly to resolve disputes through an escalation process. There are four levels of escalation:

- The individual representatives of the department and the service provider between whom the dispute may be construed to exist
- The department's Project Manager and the service provider's Project Manager associated with the foregoing representatives
- The department's Contract Manager and the service provider's Account Manager

- The Head of Department and the service provider's Managing Director.

Any dispute which cannot be settled by negotiation between the department and the service provider should be subjected to conciliation/mediation or submitted to arbitration in accordance with the relevant local rules of arbitration.

4.4 Monitor benefits achieved

To ensure that the outsourcing arrangement does provide value for money, the department needs to monitor closely the benefits achieved and check them against the projected benefits. A sample template for the review of benefits from outsourcing is provided at ***Appendix 9*** and departments are advised to take the following actions:

- Document the estimated savings based on the cost and benefit analysis conducted during the business case study for the outsourcing project
- Classify the savings between recurrent and one-off, and between realisable and notional. Detailed breakdowns will vary from case to case
- Update the estimated savings when the contract prices and other terms are finalised
- Record in the template the actual savings achieved in different phases/years of the outsourcing contract, say every six months throughout the contract period depending on the contract length and the time schedule for realisation of the benefits and after the termination/renewal of contract
- Record reasons for any deviation from the estimated savings
- Explore remedial measures to achieve the targeted savings.

Apart from tangible savings, other benefits should be identified. The realisation of benefits such as the extent of improved quality and provision of additional value-added services should also be monitored and documented.

Proper documentation of the actual costs and benefits realised against the forecasts is important as it provides essential information to ascertain the success or otherwise of the outsourcing exercise, and will help management to make informed decisions on future exercises. It also provides ready information for departments to answer enquiries. The EU is preparing a guide to post implementation reviews which is expected to be published in late 2008. This will provide more detailed advice.

4.5 Administer the contract

In carrying out the contract administration function, the department is responsible for documenting any contract variations and for re-issuing the altered contract to relevant stakeholders. This process must be consistent with the prevailing requirements of the SPR 520.

In addition, the department will need to ensure that regulatory obligations are satisfied, such as audit and access, data privacy, and other regulatory considerations.

Lastly, the department must ensure that the payment of contract fees is processed in accordance with the contract, and that timely payments are made after the services have been delivered satisfactorily. If payments for satisfactory performance are delayed, the relationship with the contractor will likely be undermined.

4.6 Seek continuous improvement

Departments should always explore ways to improve the delivery of outsourced services through improvement in internal arrangements as well as the services covered by the contract itself.

Regular review. Departments should conduct regular reviews on the outsourcing arrangements (e.g. effectiveness of contract management mechanism and labour protection measures) and identify improvement areas. Departments can consider establishing channels to share outsourcing experience with their internal units and other departments with a view to improving the outsourcing effectiveness. For important projects, a department may also consider conducting a post implementation review.

Improvement in service delivery. Ideally, the requirement for improvement should be built into the contract, e.g. requirement for improvement in customer satisfaction. Targets for improvement must be realistic, achievable but challenging. Seeking improvements is not about extracting more from the contractors against their will, but about partnering to improve the service delivery in such a way that benefits both parties.

Appendix 1
Abbreviations and Glossary of Terms

Abbreviations

CCGO	Central Cyber Government Office
CCSB	Central Consultants Selection Board
CSB	Civil Service Bureau
CTB	Central Tender Board
DoJ	Department of Justice
EoI	Expression of Interest
EU	Efficiency Unit
FSTB	Financial Services and the Treasury Bureau
GLD	Government Logistics Department
ICAC	Independent Commission Against Corruption
IT	Information technology
ITT	Invitation to Tender
LD	Labour Department
OGCIO	Office of the Government Chief Information Officer
PFO	Public Finance Ordinance
PPP	Public Private Partnership
PSI	Private Sector Involvement
SLA	Service level agreement
SPR	Stores and Procurement Regulations
WTO GPA	The World Trade Organization Agreement on Government Procurement

Glossary of Terms

Arbitration	Arbitration is a legal process for resolving contractual disputes outside the courts. The contracting parties, in accordance with the contract, refer their dispute to an arbitrator(s) for a decision (an award) which they agreed to be bound. An award has a status very like a court judgment and is enforceable in a very similar manner.
Benchmark costs	These may be the full internal costs the department is expected to pay over the term of the contract for delivery of the services. Alternatively, they may be derived from testing costs in the market place. They are established and used as a comparison with prices proposed by the tenderers to determine whether outsourcing is a competitive option from the cost perspective.
Business case	In the context of government projects the business case encompasses more than commercial criteria. A Government Business Case is a detailed and structured proposal for improvement in terms of costs, benefits and risks, justified for changing the way that government business is conducted. Departments normally develop a business case prior to the initiation of a government project or programme that requires significant commitments, including those that involve non-recurrent expenditure in procuring systems and equipment, the construction of buildings and infrastructure, and the use of the private sector in delivering public services.
Conciliation	See mediation.
Contract management	The management of the outsourcing contract on behalf of the department. 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.
Contracting out	See outsourcing.
Disaster recovery	The processes put in place by a department to ensure that the services will continue uninterrupted in the event of an event occurring that disrupts or threatens to disrupt the performance of the service. For example, in the case of a mission critical computer system, maintaining backup systems offsite.
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.
Evaluation criteria	The criteria used to evaluate service provider responses to an EoI or ITT.

Expression of Interest (EoI)	A document that the department will issue requesting information from prospective tenderers on the services they can provide and/or on the solutions available for satisfying the requirement. It is often used as a first step in the tendering process. Letters/e-mails to known interested parties, advertisements in the newspaper or an internet medium are good ways of issuing this. It is typically used in situations where the requirement cannot be adequately defined through lack of information on available solutions or when the market of service providers is not known.
Invitation to Tender (ITT)	A document that the department will issue to tenderers. The document will request that the tenderers reply to a precisely defined requirement in a prescribed format. It is typically comprised of lodging of tender, terms of tender, conditions of contract, contract schedules, service specifications, offer to be bound and articles of agreement.
Mediation	Conciliation and mediation are often terms used interchangeably. Both involve the appointment of a third party to assist the disputing parties to reach a settlement of their contractual difference. The mediator is not given any power to impose a settlement. Although mediation has no legal standing per se, the disputing parties may make the settlement legally binding by entering into a formal agreement.
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.
Relationship management	The management of the outsourcing contract relationship between the service provider and the department.
Sensitivity analysis	Analysis of the effects on an appraisal of varying the projected values of important variables.
Service continuity	The performance of the service in accordance with its defined service levels. The performance of the service must continue throughout the outsourcing process and beyond the transition and implementation phases regardless of the circumstances.
Service levels	Service levels are the standards of service with which the service provider must comply. They must be clear and measurable.
Service level agreement (SLA)	A document that defines the service performance standards that a contractor should deliver, how they will be measured, who will measure them, who will report on them and how frequently they will be reported upon.
Service provider	The organisation that will be providing the outsourced services to the department.
Statement of service requirements	The documented scope of the service that the department requires from the outsourcing arrangement.

Terms of tender This document specifies the rules of the tender process. It will typically contain obligations on both parties. It covers issues from when and how the tender will be submitted to confidentiality provisions.

A number of terms are commonly used in the private sector but are prohibited for use in the Government.

Auction techniques These are techniques designed to pressurise a tenderer into moving a price up or down and include:

- Indicating to a tenderer the price it must meet to stay in the running
- Conditional treatment based on linking other procurements outside those covered by the tender under consideration
- Advising of price relative to other tenderers (although indication that a price is too high or unrealistic is allowed)
- Furnishing information about the prices of other tenderers.

Competitive disclosure This is when the negotiator/contracting department discloses information to one tenderer that supplements the ITT and is not revealed to all other tenderers at the same time.

Technical transfusion The disclosure of technical information or intellectual property relating to a proposal that results in improvement of a competing proposal.

Appendix 2
Value for Money Check List

The following is a list of issues to consider when departments use outsourcing to deliver public services with a view to achieving value for money.

- ☑ **Appropriate levels of service.** Departments should avoid over or under specifying the service levels as well as the skills and expertise required for delivering the services to be outsourced.

- ☑ **Contract duration.** Long-term contracts encourage investment in equipment, technology and people, because costs and returns on investment can be spread over longer time periods. Such contracts should include break clauses with continuation being subject to preset service conditions, and preferably with adjustment mechanisms for the change in market price level.

- ☑ **Contract size.** Given that the effort and costs involved in processing each outsourcing contract are similar regardless of the contract size, it makes sense to ensure that the contract value is large enough to justify the effort. Related services can be bundled and undertaken by a single service provider.

- ☑ **Common goals and understanding.** It is essential for the contractor and the client department to understand and share the objectives of the outsourced project or programme. The client department should be conscious of the need to communicate clearly and effectively with its contractor(s).

- ☑ **Competition.** Much of the benefit of outsourcing arises out of the competition involved in the process, not just the use of the private sector per se. Making sensible use of competition to procure outsourced services is essential if real gains are to be achieved.

- ☑ **Cross-departmental co-operation.** There are frequent instances where two or more departments are responsible for the provision of, or are the recipients of similar services. Co-operation between departments in outsourcing these services can often achieve cost savings and service delivery improvements that would not be achievable by individual departments acting alone.

- ☑ **Dispute resolution.** Departments need to pay careful, ongoing attention to contracts to ensure that potential problems are identified early and nipped in the bud. Otherwise they may need to seek arbitration, and the costs involved can be substantial and service delivery may be disrupted.

- ☑ **Do not always select the lowest priced tender.** Beware unfeasibly low bids that may not be sustainable or cannot deliver sufficient quality.

- ☑ **Ensure that projected savings are realised.** The full benefits of outsourcing an existing service will arise only if the projected savings in in-house costs are realised. This includes not only staff but also, for example, the accommodation that the staff had occupied.

☑ **Incentives, not penalties.** Make use of incentives such as performance-linked payment to encourage good performance and continuous improvements, rather than penalties. One party to a contract cannot penalise the other. Attempts to do so will not be upheld by the courts.

☑ **Level playing field.** In conducting cost benefit analyses, the full cost/benefit to the government (not to the client department only) should be considered; otherwise the assessment is distorted.

☑ **Optimal risk allocation.** Departments should optimise – not maximise – risk transfer to the service provider. A department should avoid transferring those risks to the service provider that the provider is not best placed to manage. Otherwise, all tender bids will be inflated unnecessarily.

☑ **Outcome-based specifications.** Service specifications should, as far as possible, be outcome-based. This encourages service providers to propose innovative solutions that focus on the outcomes needed, and gives contractors greater flexibility to respond to changing circumstances.

☑ **Review existing contracts before re-use.** There is an understandable tendency for officers to re-use existing contracts without critically examining whether the department's current requirements and best practices are adequately reflected. Over time, this results in outdated contracts.

☑ **Robust tender selection.** Departments should normally adopt a "two-envelope" system. Sufficient weighting should be given to the technical/quality requirements to reflect the nature and complexity of the services to be outsourced. They can also consider setting relevant mandatory requirements and passing marks under the marking scheme.

Appendix 3
Project Team Roles

This appendix provides an overview of a typical outsourcing project team and a contract management team, as well as the functions of each key team member. There are different requirements during different stages of an outsourcing project.

Outsourcing Project Team: Preparation for Contract Succession, and Tendering and Selection

Member	Roles and responsibilities
Project Sponsor	• Held typically by a senior manager (at Directorate level) in the department • Accountable to department senior management for the success of the outsourcing project • Responsible for obtaining all necessary resources to ensure its satisfactory completion • Be provided with sufficient authority to sign off on commencing the project, and also sign off on acceptance of the project being satisfactorily completed
Project Manager	• Responsible to the Project Sponsor and perform the overall management role of the project on a day-to-day basis • Management of the project team • Day-to-day liaison with interfacing parties
Project Team Members	• Drawn from a number of disciplines, e.g. technical/operational, change management, legal, financial, etc., to provide inputs to various tasks • Filled by in-house staff or external specialist(s), depending on the task requirements • Part-time or full-time staff could be deployed, depending on project nature and scale

Contract Management Team: Contract Management

Member	Roles and responsibilities
Contract Manager	• Typically held by a senior manager responsible for the outsourced service in the department; or the head of contract management unit (if such unit exists) • Reports to senior management on contract performance • Responsible for managing the outsourcing contract; monitoring and enforcing service levels; managing the relationship between the department and the service provider • Setting the strategy for the service performance in conjunction with the Team Leader • Building an effective contract management team
Team Leader	• Facilitating reporting processes and analysing reporting data provided against the service levels set in the contract • Scrutinising service level measurement data and submitting reports to the Contract Manager • Enforcing service levels when the service provider is found under-performing • Managing the relationship with counterparts (e.g. Manager, Account Manager, Project Manager) of the service provider side through frequent communication • Managing the performance of team members
Team Members	• Assisting the Team Leader and the Contract Manager in managing the outsourcing contract • Responsible for resolving day-to-day performance issues in conjunction with the service provider • Day-to-day liaison with the service provider team members and management of the relationship at the operational level

Appendix 4
Risk Management

All activities are subject to risk whether outsourced or delivered in-house. Part of the assessment of an outsourcing option will be whether it assists with managing or mitigating risks involved in in-house delivery and whether any risks involved in outsourcing can in turn be managed or mitigated.

A structured process for risk management is described below.

Risk identification. Drawing on expert opinion, experience and published guidance as available, the department should list the various risks (inherent, planned and contractual) together with a description of the symptoms by which these risks will be recognised.

Typical risk categories include:

- site risk
- design, construction and commissioning risk
- financial risk
- operating risk
- market risk
- interface and network risk
- industrial relations risk
- political, legislative and government policy risk
- force majeure risk
- asset ownership risk

Risk assessment. The department should make a realistic assessment of the consequence, impact and likelihood of each of the risks identified.

Risk allocation. The golden rule is that the party best able to manage each risk should carry that risk. In general, the outsourcing department would be expected to bear any risk arising from variations of requirement by the Government, and legislative risk. The service provider would be expected to carry all other risks including general business risk.

Risk mitigation. The department should consider the risks unaddressed, or remaining despite existing controls, and decide whether they are acceptable in the context of the departmental and service objectives. The objective is to ensure that any residual level of risk is kept at an acceptable level in a cost effective manner.

Monitoring and review. Monitoring of the risk management programme on an ongoing basis will commonly be delegated to the contract manager. In some instances a department may delegate this task to a senior manager not connected to the outsourcing project thus providing an “outsider” viewpoint in ensuring that risks to the department are monitored and kept to a minimum.

A sample risk allocation matrix for an outsourcing project for development and operation of a call centre is shown below:

Risk description	Risk assessment	Mitigation measures	Preferred allocation
The call centre operation does not commission on schedule	• Likelihood: low • Delayed service commencement	• No payment until the call centre has been developed and in operation	Service provider
Service provider fails to meet performance standards	• Likelihood: medium • Clients of the call centre will experience a degraded service and may lodge complaints as a result	• The outsourcing department will develop a robust tender evaluation process to select a capable contractor • The service provider will be required to develop a quality assurance process and regularly report its performance • The outsourcing department will have the right to withhold performance incentives and/or service fee, step-in, exercise break clause provision, or even terminate the contract and seek liquidated damages • The outsourcing department will closely monitor the service provider's performance and conduct regular customer satisfaction surveys	Outsourcing department and service provider

Appendix 5
Examples of Service Level Agreement Terms

Service Levels	Telephone Enquiry Services	Web Services to Public
Point of delivery	Call Centre 2888 1234	Public domain of the Web
Availability (How accessible the service is to a user)	• Monday to Friday, 9:00 to 17:00 • Saturday, 9:00 to 12:00 • 99% of the time	• 24 hours per day • 7 days per week • 99.5% of the time
Reliability (Accuracy/failure of the service)	Accuracy of response > 99.5%	Maximum of 5 failures with total outages of 3 hours within a year
Response (Time to respond to a user request)	• 90% calls answered within 20 seconds • Enquiry resolved within – 10 minutes (simple) 2 working days (complicated)	Not applicable
Resolution (Time to correct problem/fault)	• Urgent problem: < 1 hour • Less urgent problem: < 1 week	Duration of any single outage: < 1 hour
Measurement period	Monthly	Monthly
Responsibility for measurement	Service provider	Service provider
Reporting frequency and method	• Report on exception basis or on request • System records	• Monthly status report • System records

Appendix 6
Transition Planning

Both the department and the service provider need to plan for the contract transition. Normally the service provider is expected to provide an indicative transition plan as part of the tender. Following selection, the department and the service provider should work together to integrate their respective transition plans.

The finalised transition plan must be adequately communicated to all interested parties throughout the process. A formal programme of communication is generally set up for outsourcing arrangements. This is to ensure that the process continues to have credibility. It is also an important part of ensuring that department staff morale is maintained and that staff are willing to assist with the transition.

The following is an outline of the elements of transition planning from the perspective of the department and the service provider. This should be used as a guide and may not be suitable for all outsourcing projects. Each project needs to consider the particular transition requirements that it involves.

Department transition planning

- **Establish a transition management committee.** This may be a time to transfer some responsibilities from the department Project Manager to the Contract Manager (see Appendix 3). In many instances the two roles are undertaken by the same person. Such an approach has some good points, but does tend to place a high level of reliance on one individual.

- **Prepare a project plan for this transition phase.** Highlight critical tasks within the transition management plan. These should contain details of responsibilities and time frames. There will be significant roles for both the department's and the service provider's representatives. The ongoing refinement of the plan is normally a part of the requirements specified in the ITT, due diligence and contract formation processes.

- **Conduct transition management meetings** and other processes to manage the transition.

- **Prepare correspondence** to be sent to the service provider and announce decision to affected staff. Also advise other stakeholders.

- **Prepare complementary human resource management plans.** The plans need to address the situation of the department's staff and of any service provider's staff assisting the transition (including sub-contractors).

- **Prepare a communication strategy.** The communication strategy is to ensure a smooth transition to new service arrangements and lay the foundation for processes of continuous improvement throughout the term of the contract.

- **Identify and prepare assets** to be transferred to the service provider, if relevant. Ensure that appropriate leases or licences are also transferred. Dispose of/redeploy surplus assets and equipment as required.

- **Finalise with the service provider the department's requirements** for the delivery of services, particularly the interfaces at operational and client service levels:

  - Confirm the prevailing legislative and administrative arrangements that govern the provision of services

  - Finalise relevant policy and procedural requirements for the delivery of services

  - Review and authorise the service provider's procedures, covering arrangements for normal operations, for specific emergencies and for specific disasters.

- **Review transition arrangements.** Review the transition process three months or so after the services commence so that:

  - Lessons are properly learned and applied to the ongoing contract operation and management

  - The next outsourcing project benefits from this experience.

Service provider transition planning

The overall transition plan is broken down into components. Broadly these can consist of the following:

- **Due diligence check.** Ideally the due diligence check should be performed in advance of the transition as it assists the service provider and the department to decide whether they wish to enter into the outsourcing arrangement. However, it is often conducted at this stage as a contractual condition that must be satisfied.

- **Transition of the service** (including any asset transfers – both third party contracts and/or physical assets). This is the core of the service provider's transition plan. It will describe how the service provider will take over a pre-existing service from the department or how it will start up a new service. For a pre-existing service, the plan will elaborate how service continuity will be maintained.

- **Human resources** issue resolution and transition. This is generally the staff recruitment, training, and transition arrangement, if any, to the new working environment.

- **Service level** monitoring and reporting arrangements. A monitoring system should be set up to measure the service levels achieved so that any discrepancy from the contractual requirements can be rectified in a timely manner. A reporting mechanism within the service provider's organisation structure and to the client department should also be established.

Transition risk assessment

This process provides a framework for ensuring that the potential risks of the transition process are addressed. It is a critical part of transition planning for both the service provider and the department. The risk assessment process entails looking at each transition activity and identifying its associated risks and how they can be managed to ensure a smooth transition and limit adverse impacts on service continuity.

Appendix 7
Issues for Drafting a Contract

The contract should be drafted with special consideration to the following:

Business continuity	Ensuring the continuation of the service throughout transition, outsourcing and any subsequent changes in contractual arrangements.
Dispute resolution procedures	Outlined in Chapter 4
Force majeure terms	These set out the procedures to be followed if service delivery is disrupted due to circumstances outside either party's control. For example, a typhoon may prevent the property management service provider from accessing a building to clean it.
Information security	Conditions should be included covering access to, and protection of, confidential information.
Integrity requirements	Tenderers should be made aware that the government intends to deal only with service providers committed to ethical business practices. Evidence should be sought that the company has, and promulgates to its staff, a company code of ethics and a staff code of conduct.
Intellectual property ownership	Both the department and the tenderer may have intellectual property rights that need to be protected. For example, if a mission-critical software program is owned by the department then the parties will need to work out an arrangement, such as licensing.
Mechanism to vary payment and price formulae	A well thought out, practical mechanism should be incorporated in the contract that will enable flexible responses to changing circumstances.
Performance guarantee or a financial undertaking	The department may consider seeking a performance guarantee from any parent company of a service provider or, if there is not a parent company, an undertaking to provide a sequestered account at a fixed sum to which the department will have unrestricted access in the case of service failure requiring the contracting of another service provider.
Performance-based incentive scheme	To encourage good performance exceeding the required service levels and provide remedial measures for non-performance.
Risk management	The risks of entering into an outsourcing arrangement should be mitigated as far as possible.

Service levels	Outlined in Chapter 2
Step-in rights	The department requires a legal right to step in and resume the service in the event of serious default, or to replace the existing service provider.
Termination and transition to a new service provider	The contract should establish the rules for early contract termination as well as the process for transition to a new service provider. The department will need to consider the time it will take to go to market again, select a service provider, hand over and install the new service provider.
The World Trade Organization Agreement on Government Procurement (WTO GPA)	Where procurements are covered by the WTO GPA, they are subject to additional requirements. For corresponding tendering practices and procedures, see Financial Circular No. 10/97. In regard to the challenges faced by departments, see Chapter 3 of the User Guide to Contract Management for details.
Transfer of assets and employees	This is rare in existing outsourcing examples in Hong Kong. However, it is a feature of much international experience.
Transition-in-service	An obligation should be imposed on the service provider to provide a detailed transition plan.
Value-added services	Tenderers may be able to provide value-added services. Tenders normally contain a standard clause advising that alternative proposals that improve the offer (e.g. fully conforming to the mandatory requirements but containing desirable features in addition to those specified in the tender documents) may be submitted and will be considered by departments in their evaluation of tenders.

Appendix 8
Contract Negotiation

The following are the processes related to contract negotiation that departments should take note of before commencing the negotiation with a tenderer or tenderers.

Establish the negotiating team. The composition of the negotiating team may differ from the tender assessment panel as different areas of specialist knowledge are required. For example, legal advisers might be essential for this part of the process. The team should involve key stakeholders from the department who are decision-makers able to legally bind the department (at the Directorate level). Most importantly the negotiations should be led by an experienced negotiator. For tenders administered by the GLD on behalf of another department, normally the GLD will lead the negotiating team.

The negotiating teams of both parties should comprise members with the authority to decide on behalf of their organisations and to commit their organisations to the terms and conditions agreed. The department's negotiating team will need to seek direction from the relevant tender board on the limits within which the negotiations and commitments can be made. Depending upon these, the negotiations may be on a "without prejudice" basis and subject to the ratification of the relevant tender board.

Set the negotiation framework. A value for money outsourcing arrangement does not rest merely on price. Think about risk, innovation and flexibility - for both parties to the contract. Keep this in mind during contract negotiations. The department needs to set terms for negotiations at this point. This is a framework around which the contract negotiations will be conducted, and will feature the following:

- **Agree the timetable for negotiations:** set a time scale for completion of the negotiations
- **Determine the most important negotiation points and a position on each**
- **Prepare an agenda for the negotiations**
- **Confirm that the contract will deliver the outsourcing objectives:** this needs to be done at this stage as it is one of the last opportunities to review the deal to ensure it will deliver the expected benefits
- **Determine the key risks and the approach to be taken:** prohibited negotiating behaviours are outlined in the SPR 385 and its Appendix III (J). They include technical transfusion, auction techniques and competitive disclosure (see glossary at Appendix 1)
- **Do not introduce new issues or revisit agreed matters:** the parties should not admit new issues into negotiations (i.e. issues not previously raised in bids nor signalled in setting up the negotiation framework). In addition the parties should agree not to reintroduce issues already agreed in the negotiations

- **Recording of agreed matters:** keep a record of all matters agreed during the negotiations so they may be recorded in contract drafts. Accordingly, this must be recorded in meeting notes and agreed at the end of each meeting

- **Ensure that all ordinances and regulatory constraints are reflected in the final contract:** as the department drafts the tender documents, all amendments will be managed by it

- **Version control of altered documents:** the altered versions must be issued sequentially and in compliance with any departmental document naming conventions

- **Agree a dispute escalation and resolution process:** in case negotiations reach an impasse, there should be an agreed process for overcoming this. This typically will involve escalating matters to more senior management for resolution. Accordingly, the parties need to ensure that appropriate senior managers will be available throughout the course of the negotiations.

Negotiate a value for money contract. Throughout the contract negotiations, it is important to bear in mind that the ultimate outcome is to set the terms and parameters for a strategic partnership rather than simply the procurement of a service. The finished contract will be the foundation of this relationship and should reflect that. The best value for money will be achieved by setting common objectives, sharing risk, encouraging innovation and maintaining flexibility. In such a contract, the terms and conditions will not be heavily biased in favour of the department.

For example, many companies work on a shorter payment period than departments. Reaching a mutually acceptable time period between invoicing and payment could solve short-term cash flow problems for the service provider and earn the department a discount.

The result of the contract negotiations should be a final version of the contract. This will be drafted to reflect everything that the parties have agreed. Both parties should have sufficient time to review the final copy and obtain the necessary internal approvals to formalise the contract. It is not always possible to ensure every detail is finalised prior to finalising the contract. Unresolved matters should be kept to a minimum.

For example, the details of the reporting can be finalised after the contract is signed. In general, issues that are unlikely to cause a breakdown in the relationship between the parties can be resolved after the contract is signed.

In addition, the contract may be conditional on a number of matters being successfully resolved.

For example, the contract may be conditional on the successful transition into the new service. Accordingly, if the service is not successfully transitioned across to the service provider then the department would have the right to terminate the contract.

Appendix 9
Outsourcing Benefit Analysis

A sample template may look like the following:

Summary

Tangible Benefits	Estimated Savings ($M)	Actual Savings ($M)	Reasons for Deviation
Recurrent Savings (from year to year)			
(I) Realisable Savings			
(II) Notional Savings			
Non-recurrent Savings (during year(s))			
(I) Realisable Savings			
(II) Notional Savings			

These figures should be net savings, taking into account all cost elements arising from the outsourcing (e.g. payment to contractor, contract management and staff redundancy). Details should be shown on the schedule on the next page.

Intangible Benefits	Planned	Realised
(I) Service Standards		
(II) Additional Services		
(III) Accessibility Improvements		
(IV) Others (specify if any)		

Tangible Benefits: Details

Tangible Benefits	Estimated Savings ($M)	Actual Savings ($M)	Reasons for Deviation
Recurrent Savings (from year to year)			
(I) Realisable Savings			
(a) Reduction in staff costs (deletion of existing/approved posts)			
(b) Reduction in other operational costs (e.g. consumables, hire of services)			
(c) Increase in revenue to the government			
(d) Reduction in costs incurred by other departments (e.g. rental payment)			
(e) Others (specify if any)			
(II) Notional Savings			
(a) Fragmented staff savings for internal redeployment			
(b) Increase in productivity			
(c) Cost avoidance to meet growing demand or future needs (e.g. avoidance of additional staff and replacement of equipment)			
(d) Reduction in costs currently not charged to the department (e.g. government accommodation)			
(e) Others (specify if any)			
Non-recurrent Savings (during year(s))			
(I) Realisable Savings			
(a) Revenue from transfer/sale of assets			
(b) Others (specify if any)			
(c) Offsetting costs of implementation (e.g. write-off of assets, redundancy costs)			
(II) Notional Savings			
(a) Avoidance of capital investment (e.g. system development for new service)			
(b) Others (specify if any)			

Taking Advice and Guidance

EU's role in government outsourcing

The EU offers departments a wide range of services and know-how. It can conduct:

- Cross-departmental project studies
- Business case/feasibility studies
- Re-engineering/performance improvement services to facilitate outsourcing decisions
- Project planning, scoping studies, and implementation planning
- Drafting contracts, service level agreements and other procurement documents
- Tender evaluation criteria development
- Establishment of contract administration and relationship management regimes
- Training courses, seminars, experience sharing sessions, brain storming sessions, etc
- Help desk services.

Other private sector involvement options

Apart from outsourcing, there are other private sector involvement (PSI) options that may address the challenges faced by departments. The EU is able to advise departments on the common PSI options, and their advantages and disadvantages. The *"Serving the Community by Using the Private Sector: Policy and Practice"* guide provides a reference for departments wishing to better understand the range of PSI arrangements. Copies of these and other guides are available on the EU website and from the Public Sector Reform Information Centre in the CCGO.

Departments are invited to contact the EU Help Desk on **2165 7255** or **euwm@eu.gov.hk**

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 Finance Committee/Public Works Sub-committee endorsements. 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 tender 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 **OGCIO** can advise on projects involving the provision of information technology infrastructure and services.

Efficiency Unit
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