

CHAPTER 9

Leisure and Cultural Services Department

<p>Outsourcing of services in the Leisure and Cultural Services Department</p>

**Audit Commission
Hong Kong
25 October 2007**

This audit review was carried out under a set of guidelines tabled in the Provisional Legislative Council by the Chairman of the Public Accounts Committee on 11 February 1998. The guidelines were agreed between the Public Accounts Committee and the Director of Audit and accepted by the Government of the Hong Kong Special Administrative Region.

Report No. 49 of the Director of Audit contains 12 Chapters which are available on our website at <http://www.aud.gov.hk>.

Audit Commission
26th floor, Immigration Tower
7 Gloucester Road
Wan Chai
Hong Kong

Tel : (852) 2829 4210
Fax : (852) 2824 2087
E-mail : enquiry@aud.gov.hk

OUTSOURCING OF SERVICES IN THE LEISURE AND CULTURAL SERVICES DEPARTMENT

Contents

	Paragraph
PART 1: INTRODUCTION	1.1
Background	1.2
Audit review of government outsourcing	1.3
Outsourcing of services in the LCSD	1.4 – 1.6
General response from the Administration	1.7
Acknowledgement	1.8
PART 2: PROTECTION OF NON-SKILLED WORKERS ENGAGED IN OUTSOURCING CONTRACTS	2.1
Government measures to protect non-skilled workers	2.2 – 2.3
Employment-related irregularities in LCSD outsourcing contracts	2.4 – 2.8
<i>Audit observations</i>	2.9 – 2.11
<i>Audit recommendations</i>	2.12
Response from the Administration	2.13 – 2.15
Monitoring work to safeguard workers' benefits	2.16
<i>Audit observations</i>	2.17 – 2.24
<i>Audit recommendations</i>	2.25
Response from the Administration	2.26 – 2.28
PART 3: TENDER EVALUATION AND CONTRACT ADMINISTRATION	3.1
Tender procedures	3.2
Review of the systems for tender evaluation and contract administration	3.3 – 3.4

	Paragraph
Assessing tenderers' past performance	3.5
<i>Audit observations</i>	3.6 – 3.9
<i>Audit recommendations</i>	3.10
Response from the Administration	3.11
Contractors' obligations before commencement of contracts	3.12
<i>Audit observations</i>	3.13 – 3.15
<i>Audit recommendations</i>	3.16
Response from the Administration	3.17
Market interest in providing sports centre management services	3.18 – 3.22
<i>Audit observations</i>	3.23 – 3.26
<i>Audit recommendations</i>	3.27
Response from the Administration	3.28
Sub-contracting sports centre management services	3.29
<i>Audit observations</i>	3.30 – 3.33
<i>Audit recommendations</i>	3.34
Response from the Administration	3.35
Employing people with disabilities	3.36 – 3.37
<i>Audit observations</i>	3.38 – 3.41
<i>Audit recommendations</i>	3.42
Response from the Administration	3.43 – 3.45
Use of outcome-based contracts	3.46 – 3.47
<i>Audit observations</i>	3.48 – 3.49
<i>Audit recommendation</i>	3.50
Response from the Administration	3.51

	Paragraph
PART 4: MONITORING THE PERFORMANCE OF CONTRACTORS	4.1
Background	4.2 – 4.4
Review of the monitoring of contractor performance	4.5 – 4.6
Daily monitoring	4.7 – 4.10
<i>Audit observations</i>	4.11 – 4.16
<i>Audit recommendations</i>	4.17
Response from the Administration	4.18
Supervisory inspections of leisure facilities	4.19
<i>Audit observations</i>	4.20 – 4.23
<i>Audit recommendation</i>	4.24
Response from the Administration	4.25
Enhanced supervisory inspections of swimming pools	4.26
<i>Audit observations</i>	4.27 – 4.28
<i>Audit recommendations</i>	4.29
Response from the Administration	4.30
Regulatory actions on unsatisfactory performance	4.31
<i>Audit observations</i>	4.32 – 4.37
<i>Audit recommendations</i>	4.38
Response from the Administration	4.39
Assessing the performance of contractors	4.40 – 4.42
<i>Audit observations</i>	4.43 – 4.44
<i>Audit recommendations</i>	4.45
Response from the Administration	4.46

	Paragraph
PART 5: PERFORMANCE MANAGEMENT AND CONTINGENCY PLANNING	5.1
Effectiveness of outsourcing	5.2 – 5.4
<i>Audit observations</i>	5.5
<i>Audit recommendation</i>	5.6
Response from the Administration	5.7
Performance measurement and reporting	5.8
<i>Audit observations</i>	5.9 – 5.10
<i>Audit recommendations</i>	5.11
Response from the Administration	5.12
Contingency planning	5.13 – 5.15
<i>Audit observations</i>	5.16 – 5.19
<i>Audit recommendation</i>	5.20
Response from the Administration	5.21

	Page
Appendices	
A : Organisation chart of the LCSD (July 2007)	56
B : Government measures to protect non-skilled workers	57 – 58
C : LCSD departmental warning system for service contracts	59
D : Acronyms and abbreviations	60

PART 1: INTRODUCTION

1.1 This PART describes the background to the audit and outlines the audit objectives and scope.

Background

1.2 Government outsourcing is an arrangement where a department contracts with an external service provider for a continuous period for the provision of services specified and paid by the department. This arrangement supports the Government's policy of serving the community by engaging private-sector services. The common objectives of government outsourcing include:

- (a) improving existing services and meeting increasing demands and new service requirements;
- (b) attaining better cost-effectiveness and efficiency;
- (c) increasing flexibility of responding to fluctuating demands;
- (d) containing growth in the civil service; and
- (e) gaining access to new skills and technology in the market place.

Audit review of government outsourcing

1.3 The Audit Commission (Audit) has recently conducted a review of government outsourcing, which covers the Leisure and Cultural Services Department (LCSD), the Food and Environmental Hygiene Department (FEHD) and the Housing Department (HD). These three departments have had substantial outsourcing activities. According to the 2006 Survey on Government Outsourcing conducted by the Efficiency Unit (EU), these three departments had an annual outsourcing expenditure on non-works contracts (i.e. service contracts) of \$5.2 billion, accounting for about 43% of the total government outsourcing expenditure on such contracts. The audit findings are contained in three separate reports, as follows:

- (a) outsourcing of services in the Leisure and Cultural Services Department (the subject matter of this report);
- (b) outsourcing of environmental hygiene services (see Chapter 8 of the Director of Audit's Report No. 49); and

- (c) outsourcing of the management of public rental housing estates (see Chapter 10 of the Director of Audit's Report No. 49).

Outsourcing of services in the LCSD

1.4 The LCSD provides leisure and cultural services. It manages a wide range of leisure and cultural facilities and organises diversified recreational activities and cultural programmes. The LCSD has been outsourcing part of its services. The four major types of outsourced services are:

- (a) cleansing (see Photograph 1);
- (b) security (see Photograph 2);
- (c) horticultural maintenance; and
- (d) sports centre management.

As at 31 July 2007, the LCSD had 104 outsourcing contracts with a total contract value of \$1.88 billion. These contracts involved 48 contractors and engaged 7,610 workers (see Table 1).

Photograph 1

Outsourced cleansing services at a cultural venue



Source: LCSD records

Photograph 2

Outsourced security services at a cultural venue



Source: LCSD records

Table 1

Outsourcing contracts of the LCSD (31 July 2007)

Type of services	Number of contracts	Number of contractors	Contract value (\$ million)	Number of workers engaged
Cleansing	47	19	973.5	3,627
Security	31	13	451.8	3,034
Horticultural maintenance	17	11	287.6	821
Sports centre management	9	5	164.6	128
Total	104	48	1,877.5	7,610

Source: LCSD records

1.5 The Leisure Services Branch, the Cultural Services Branch, and the Supplies Section of the Finance and Supplies Division of the LCSD are involved in the management of outsourcing contracts. Their main responsibilities are as follows:

- (a) ***Leisure Services Branch.*** This Branch manages leisure facilities and organises recreational and sports activities. It has three Divisions under which there are 18 District Leisure Services Offices (DLSOs). Staff of the DLSOs are responsible for preparing service requirements of tenders and monitoring contractor performance;
- (b) ***Cultural Services Branch.*** This Branch manages cultural facilities and organises cultural programmes. It has three Divisions (i.e. the Heritage and Museums Division, the Libraries and Development Division, and the Performing Arts Division) which look after various cultural venues. Staff of the cultural venues are responsible for preparing service requirements of tenders and monitoring contractor performance; and
- (c) ***Supplies Section.*** This Section plays a support role. It develops standard contract terms and conditions, and provides administrative and logistic support to user sections in tendering and contract management.

An organisation chart of the LCSD is at Appendix A.

1.6 The objective of this audit review is to examine the economy, efficiency and effectiveness of LCSD management of outsourcing contracts. The review has found that there is scope for improvement in the following areas:

- (a) protection of non-skilled workers engaged in outsourcing contracts (PART 2);
- (b) tender evaluation and contract administration (PART 3);
- (c) monitoring the performance of contractors (PART 4); and
- (d) performance management and contingency planning (PART 5).

General response from the Administration

1.7 The **Director of Leisure and Cultural Services** generally agrees with the audit observations and accepts the recommendations. He has said that he is grateful to Audit for working with the LCSD to explore opportunities for improving value for money of its services.

Acknowledgement

1.8 Audit would like to acknowledge with gratitude the full cooperation of the staff of the LCSD during the course of the audit review.

PART 2: PROTECTION OF NON-SKILLED WORKERS ENGAGED IN OUTSOURCING CONTRACTS

2.1 This PART examines the measures taken to protect the rights and benefits of non-skilled workers engaged by contractors in outsourcing contracts of the LCSD.

Government measures to protect non-skilled workers

2.2 The Government is committed to ensuring that public services, whether provided internally by departments or externally by contractors, are delivered to the highest practicable standards and in a socially responsible and ethical manner. 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 (see Appendix B). Key measures applicable to 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 and Demerit Point System.*** Financial Circular (FC) No. 3/2004 of March 2004 stipulated:
 - (i) a mandatory requirement on past conviction records (see also item (d)(i) below); and
 - (ii) the implementation of a service-wide Demerit Point System (DPS), under which a contractor would be issued a default notice (DN) which attracted one demerit point (see also item (d)(ii) below);
- (b) ***Committed wage level.*** FC No. 5/2004 of May 2004 stipulated a mandatory requirement on wage level for non-skilled workers;
- (c) ***Standard employment contract.*** The Financial Services and the Treasury Bureau (FSTB) promulgated in April 2005 the mandatory requirement to use a standard employment contract (Note 1); and
- (d) ***Tightened measures on management of service contractors.*** In FC No. 4/2006 of April 2006, the FSTB promulgated tightened measures, including:

Note 1: *The Government's standard employment contract, which requires government contractors to set out clearly the monthly wages, working hours, method of wage payment and other employment terms and conditions, was drawn up on the advice of the Labour Department.*

- (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 DPS) 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.

2.3 The various FCs have also stipulated that government departments:

- (a) should satisfy themselves that the terms of the outsourcing contracts are clear and enforceable;
- (b) should be responsible for administering the contracts, including devising a monitoring mechanism to ensure that the contractors comply with the terms of the contracts;
- (c) should strengthen the monitoring measures and step up investigations into suspected/reported non-compliance cases to ensure that contractors comply with employment-related contractual requirements; and
- (d) may seek the assistance of the Labour Department (LD) when they have grounds to suspect that contractors/sub-contractors have breached the Employment Ordinance (Cap. 57) and/or when there are disputes between the contractor and his employee over the terms of an employment contract.

Employment-related irregularities in LCSD outsourcing contracts

2.4 For the four major types of LCSD outsourcing contracts (see para. 1.4), the contractors employed a large number of non-skilled workers. As at July 2007, there were 7,610 workers (mainly non-skilled workers) engaged in these contracts.

Cases of employment-related irregularities

2.5 Upon receiving reports of suspected cases of employment-related irregularities relating to its outsourcing contracts, the LCSD would investigate the cases and take necessary follow-up actions (such as referrals to law enforcement agencies). These cases mainly originated from complaints lodged by workers or trade unions, observations of

front-line staff, and information received from other departments. Table 2 shows the number of such cases relating to LCSD outsourcing contracts in the last five financial years.

Table 2

**Employment-related irregularities relating to LCSD outsourcing contracts
(2002-03 to 2006-07)**

Year	Number of suspected cases (Note 1)	Number of substantiated cases (Note 2)
2002-03	5	2
2003-04	6	1
2004-05	5	3
2005-06	7	2
2006-07	10	3
Total	33	11

Source: LCSD records

Note 1: Suspected cases mainly originated from complaints lodged by workers or trade unions, observations of front-line staff, and referrals from other departments.

Note 2: Substantiated cases are those cases which, after LCSD investigation, were rectified/mediated (with or without sanctions, e.g. issue of DNs), or referred to law enforcement agencies for follow-up action.

Contracts undertaken by convicted contractors

2.6 In a reply to a Legislative Council question on 10 January 2007, the Administration informed Members that, during the period May 2005 to December 2006, a total of 45 security services companies or cleansing services companies were convicted of the relevant provisions under the ordinances specified in FC No. 4/2006 (see para. 2.2(d)(i)). Of these cases, 20 (44%) companies had their conviction records arising from government outsourcing contracts. As at January 2007, 8 of the 20 convicted companies were still undertaking 40 government outsourcing contracts. As the tenders for all these contracts were invited before May 2006, they were not subject to the tightened measures of FC No. 4/2006 (see para. 2.2(d)).

2.7 Of these 40 government outsourcing contracts undertaken by contractors with conviction records as at January 2007, three contracts (8%) had been awarded by the LCSD to two contractors with a total contract value of \$77 million, accounting for 4% of the value (\$1.88 billion — see para. 1.4) of all LCSD outsourcing contracts as at 31 July 2007. All these three contracts (the tenders of which had been invited before the tightened measures of FC No. 4/2006 came into effect) were still in force at the time of audit fieldwork (July 2007). Table 3 shows details of these contracts.

Table 3
LCSD contracts undertaken by convicted contractors
(July 2007)

Contractor	Contract	Start date	End date	Contract period (No. of years)	Contract value (\$ million)
<i>Security services</i>					
A	1	June 2005	May 2008	3	6.26
<i>Cleansing services</i>					
B	2	October 2005	September 2008	3	69.48
	3	June 2006	May 2009	3	1.57
Total					77.31

Source: LCSD records

Contracts undertaken by contractors with demerit points under the DPS

2.8 During the period April 2004 to July 2007, 24 demerit points under the service-wide DPS were issued to 11 government contractors (Note 2). As at July 2007, 7 of these 11 contractors were providing services to the LCSD, involving 32 outsourcing contracts with a total value of \$861 million. This amount represented 46% of the value (\$1.88 billion — see para. 1.4) of all LCSD outsourcing contracts as at 31 July 2007.

Note 2: Two of these contractors received from the LCSD a total of three demerit points.

Audit observations

Need to monitor closely employment-related irregularities

2.9 As shown in Table 2, in the past five financial years, the LCSD recorded a total of 33 suspected cases and 11 substantiated cases of employment-related irregularities. Comparing with 2002-03, there was a small increase in the number of suspected/substantiated cases in 2006-07. This showed that employment-related irregularities in outsourcing contracts remained an issue to be addressed by the LCSD. This was corroborated by the fact that:

- (a) two contractors had received demerit points from the LCSD since April 2004 (see Note 2);
- (b) 46% of LCSD outsourced services were provided by those contractors who had received one or more demerit points under the service-wide DPS as at July 2007 (see para. 2.8); and
- (c) Audit review of LCSD monitoring of contractor performance (see paras. 4.31 to 4.37) revealed one case in which a demerit point under the DPS could have been issued but was not (see Case 3 in para. 4.35).

Audit considers that the LCSD needs to continue monitoring closely the incidence of employment-related irregularities in its outsourcing contracts.

2.10 For the outsourcing contracts the tenders of which were invited by the LCSD on or after 1 May 2006, up to July 2007, no demerit point had been issued under the DPS. It appears that the introduction of the tightened measures in May 2006 has had some deterrent effect. **However, in view of the short time elapsed after the implementation of the tightened measures, the LCSD needs to review, in due course, whether such measures are effective in fostering good workforce management practices among its outsourcing contractors.**

Need to adopt a risk management approach in labour protection enforcement work

2.11 In order to assess the risks of employment-related irregularities in outsourcing contracts, it is important to monitor the track records of contractors. Contractors with conviction records or demerit points under the DPS need closer scrutiny. As shown in Table 3, as at July 2007, three LCSD contracts were still undertaken by convicted contractors. Besides, 32 contracts were undertaken by contractors who had received one demerit point or more under the service-wide DPS as at July 2007 (see para. 2.8). **The LCSD may consider adopting a risk management approach in its labour protection**

enforcement work, focusing its efforts on monitoring the employment-related performance of high-risk contractors (such as those with conviction records or demerit points). Enforcement action should be taken against such contractors if they commit employment-related offences.

Audit recommendations

2.12 **Audit has recommended that the Director of Leisure and Cultural Services should:**

Need to monitor closely employment-related irregularities

- (a) **continue monitoring closely the incidence of employment-related irregularities in LCSD outsourcing contracts;**
- (b) **review, in due course, whether the tightened labour protection measures are effective in fostering good workforce management practices among LCSD outsourcing contractors; and**

Need to adopt a risk management approach in labour protection enforcement work

- (c) **consider adopting a risk management approach in LCSD labour protection enforcement work, focusing its efforts on monitoring the employment-related performance of high-risk contractors.**

Response from the Administration

2.13 **The Director of Leisure and Cultural Services** accepts the audit recommendations. He has said that the LCSD will:

- (a) continue monitoring closely the incidence of employment-related irregularities in outsourcing contracts;
- (b) review regularly the effectiveness of the tightened labour protection measures introduced in 2006 in fostering good workforce management practices amongst contractors; and
- (c) adopt a risk management approach and devise an assessment mechanism to determine the risk levels of individual contractors.

2.14 The **Commissioner for Labour** has said that:

- (a) the LD takes a serious view on the exploitation of non-skilled workers engaged by government service contractors, and will continue to conduct vigorous workplace inspections to ensure compliance on the part of government service contractors with the provisions of the Employment Ordinance and the Employees' Compensation Ordinance (Cap. 282); and
- (b) if procuring departments detect any suspected cases of non-compliance with the Employment Ordinance and/or failure to comply with the compulsory insurance requirements under the Employees' Compensation Ordinance, they should refer the cases to the LD for investigation and follow-up actions.

2.15 The **Secretary for Financial Services and the Treasury** agrees with the audit recommendations, which are generally in line with the FSTB guidelines set out in FC No. 4/2006.

Monitoring work to safeguard workers' benefits

2.16 The LCSD monitors the employment-related performance of its outsourcing contractors in order to safeguard the benefits of non-skilled workers. Such work includes the following:

- (a) *Issuing DNs under the DPS.* The LCSD has implemented all the government-wide measures to protect non-skilled workers (see para. 2.2);
- (b) *Interviewing workers.* Staff of user sections conduct worker interviews. The main purpose is to ensure that workers have received the wages as reported by the contractors; and
- (c) *Certified Public Accountant (CPA) certification scheme.* Since mid-2005, the LCSD has included a contract condition in its outsourcing contracts, requiring a contractor to submit each month a "Statement of Deployment and Wages of Workers" certified by a CPA to support the contractor's application for monthly payment of services. The CPA has to certify that the information in the statement is in accordance with the relevant employment agreements, payrolls, books, records and supporting documents. The main purpose is to ensure that the workers have been paid no less than the wages specified in the contracts.

The audit review has found that there is scope for improvement in LCSD monitoring work (see paras. 2.17 to 2.24).

Audit observations

Need to strictly follow guidelines on the issue of demerit points under the DPS

2.17 Audit reviewed LCSD monitoring of the performance of outsourcing contractors and noted that there were cases where:

- (a) regulatory actions were warranted, but either no or late actions were taken (see paras. 4.33 and 4.34); or
- (b) the regulatory actions taken were not commensurate with the seriousness of the defaults (see paras. 4.35 to 4.37).

In particular, Case 3 in paragraph 4.35 related to a breach of contractual obligations that, in Audit's view, could have been dealt with by taking appropriate regulatory actions (such as issuing a DN under the DPS).

2.18 The FSTB has issued detailed guidelines (see paras. 2.2 and 2.3, and Appendix B) on the government-wide measures to protect non-skilled workers. **The LCSD needs to remind all staff concerned to strictly follow these FSTB guidelines, particularly regarding the issue of DNs that attract demerit points under the DPS.** If necessary, the advice of the FSTB should be sought.

Need for clear guidelines on worker interviews

2.19 Worker interviews provide an effective means to detect and deter employment-related irregularities in outsourcing contracts. From visits to three DLSOs of the Leisure Services Branch and three venues of the Cultural Services Branch (see para. 4.5), Audit noted that the staff responsible for monitoring contractor performance had conducted worker interviews as required. However, they adopted different interviewing practices. For example, the three sub-districts under DLSO II (see para. 4.5(a)) had different practices (see Table 4).

Table 4
Interviewing practices adopted by DLSO II

Sub-district	Extent of interview	Documentation of interview
A	All workers	Yes (Note)
B	A sample of workers	Yes (Note)
C	A sample of workers	No

Source: LCSD records

Note: Different forms were used for documenting the interviews.

2.20 **The LCSD needs to issue guidelines to its staff to ensure that worker interviews are conducted in an effective and consistent manner.** Such guidelines should cover, for example, the number/percentage of workers to be interviewed (see also para. 2.23), the questions to be asked, and the documentation required.

Need to improve the CPA certification scheme

2.21 According to the provisions of the outsourcing contracts, the purpose of the CPA certification is to substantiate that the workers have been paid no less than the wages specified in the contracts, and contributions have been made in accordance with the Mandatory Provident Fund Schemes Ordinance (Cap. 485).

2.22 Audit noted that the certified “Statements of Deployment and Wages of Workers” submitted by outsourcing contractors did not contain information about the Mandatory Provident Fund (MPF) contributions. **The LCSD needs to consider revising the “Statement of Deployment and Wages of Workers” to specifically include the MPF contributions.**

Need to share experience with other departments

2.23 Audit noted that the HD adopted good practices that enhance its monitoring work to protect non-skilled workers engaged in outsourcing contracts. For example, the HD issued clear guidelines in the form of Best Practice Notes/Instructions, requiring its estate staff, among other things, to interview at least one worker or 5% of the contractor’s workers (whichever was the higher) to confirm with them the wage payments on the salary statements and follow up on irregularities found.

2.24 **Audit considers it useful for the LCSD to share experience with other departments that are active in the outsourcing of services involving non-skilled workers.**

Audit recommendations

2.25 **Audit has *recommended* that the Director of Leisure and Cultural Services should:**

Need to strictly follow guidelines on the issue of demerit points under the DPS

- (a) **remind LCSD staff to strictly follow the FSTB guidelines on the government-wide measures to protect non-skilled workers, particularly regarding the issue of DNs that attract demerit points under the DPS;**

Need for clear guidelines on worker interviews

- (b) **issue guidelines to LCSD staff to ensure that interviews of non-skilled workers employed by contractors are conducted in an effective and consistent manner;**

Need to improve the CPA certification scheme

- (c) **consider revising the “Statement of Deployment and Wages of Workers” so that information about the MPF contributions is also certified by a CPA; and**

Need to share experience with other departments

- (d) **share experience with other departments that are active in the outsourcing of services involving non-skilled workers.**

Response from the Administration

2.26 The **Director of Leisure and Cultural Services** accepts the audit recommendations. He has said that:

- (a) regarding paragraph 2.25(a), the LCSD has repeatedly reminded all staff concerned to strictly follow the FSTB guidelines on the issue of DNs attracting demerit points by means of issuing departmental circulars and conducting training sessions;
- (b) regarding paragraph 2.25(b), the LCSD is preparing a set of guidelines on checking the protection of workers' rights, including the use of a standard interview form and determination of sample size for interviewing workers of contractors classified at different risk levels;
- (c) regarding paragraph 2.25(c), the LCSD is considering including contractors' MPF contributions to trustees in the CPA checking and reporting of the same in the "Statement of Deployment and Wages of Workers". In this regard, there are occasions where contractors had already made contributions to the MPF trustees but the trustees did not update the MPF members' accounts promptly; and
- (d) regarding paragraph 2.25(d), the LCSD has frequent contacts with other major procuring departments at various levels for sharing views on contract management and outsourcing of services involving non-skilled workers. It will continue to strengthen the cooperation in future.

2.27 The **Commissioner for Labour** has said that the LD organises from time to time briefings and seminars to familiarise responsible officers of procuring departments with the provisions of the Employment Ordinance and the standard employment contract, and discusses with them possible measures to curb exploitative labour practices of unscrupulous contractors.

2.28 The **Secretary for Financial Services and the Treasury** agrees with the audit recommendations, which are generally in line with the FSTB guidelines set out in FC No. 4/2006.

PART 3: TENDER EVALUATION AND CONTRACT ADMINISTRATION

3.1 This PART examines LCSD evaluation of tenders and administration of contracts for the outsourcing of services.

Tender procedures

3.2 LCSD tender procedures for the outsourcing of services are as follows:

- (a) ***Determination of service requirements and estimated contract prices.*** The user section requiring the outsourcing of services determines the service requirements, including manpower and service levels. Based on the service requirements, it estimates the contract price and assesses whether funds are available to cover the estimated contract price. The user section head will endorse the invitation of tenders only when it is confirmed that funds are available;
- (b) ***Invitation of tenders.*** The Supplies Section invites tenders by open tendering;
- (c) ***Two-envelope approach.*** The LCSD adopts the two-envelope approach. A tenderer is required to submit his technical offer and price offer in separate envelopes;
- (d) ***Tender evaluation.*** A tender assessment panel is formed to evaluate the tenders received. The panel will first conduct a technical assessment and then a price assessment. Tender evaluation is conducted in accordance with a pre-approved standard marking scheme; and
- (e) ***Submission of tender report.*** The tender assessment panel will prepare a tender report for submission to the relevant authority (Note 3), seeking approval for awarding the contract to the selected tenderer.

Note 3: *The authorities for the acceptance of tenders are as follows:*

<i>Tender value</i>	<i>Authority for acceptance of tender</i>
<i>over \$650,000 to \$1.3 million</i>	<i>The Principal Supplies Officer (Supplies Section) or a directorate grade officer</i>
<i>over \$1.3 million to \$10 million</i>	<i>Government Logistics Department Tender Board chaired by the Director of Government Logistics</i>
<i>over \$10 million</i>	<i>Central Tender Board chaired by the Permanent Secretary for Financial Services and the Treasury (Treasury)</i>

For the procurement of services with value equal to or below \$650,000, quotations are required.

Review of the systems for tender evaluation and contract administration

3.3 Audit examined a sample of eight tender exercises for the outsourcing of LCSD services. The sample included two tender exercises from each of the four major types of outsourced services (see para. 1.4). The contracts awarded under these tender exercises were still in force at the time of audit fieldwork (July 2007). The total value of the contracts awarded from these eight tender exercises amounted to \$553 million, representing some 30% of the value of all LCSD outsourcing contracts as at July 2007.

3.4 Audit notes that, in general, LCSD systems and procedures for tender evaluation and administration of outsourcing contracts are operating satisfactorily. There are, however, a number of areas where further improvements can be made, including:

- (a) assessing tenderers' past performance (see paras. 3.5 to 3.11);
- (b) contractors' obligations before contract commencement (see paras. 3.12 to 3.17);
- (c) market interest in providing sports centre management services (see paras. 3.18 to 3.28);
- (d) sub-contracting sports centre management services (see paras. 3.29 to 3.35);
- (e) employing people with disabilities (see paras. 3.36 to 3.45); and
- (f) use of outcome-based contracts (see paras. 3.46 to 3.51).

Assessing tenderers' past performance

3.5 The LCSD uses marking schemes to evaluate tenders. Each type of services has its own marking scheme, which consists of the following two parts:

- (a) technical assessment (accounting for 30% of the combined score); and
- (b) price assessment (accounting for 70% of the combined score).

For the technical assessment, the past performance of a tenderer is an important assessment criterion. Past performance accounts for 15% of the technical score for cleansing, security and horticultural maintenance service tenders, and 12% of the technical score for sports centre management service tenders.

Audit observations

3.6 In assessing the past performance of a tenderer, the tender assessment panel makes reference to the documents submitted by the tenderer. The documents usually include reference letters or appreciation letters given by the tenderer's other clients. If the tenderer is an existing or a former contractor of the LCSD, the panel will also refer to the in-house performance information available. Such information is usually in the form of monthly and half-yearly assessment reports (see paras. 4.40 to 4.42).

Performance information submitted by tenderers

3.7 Audit noted that the documents submitted by tenderers about their performance took many forms, including reference letters, appreciation letters, and results of surveys conducted by themselves. Most of these documents contained general comments that the tenderers' performance was satisfactory. The tender assessment panel relied on these documents in assessing the past performance of tenderers, without seeking independent and more specific performance information from the tenderers' other clients. **The LCSD needs to design forms for inviting tenderers' other clients to provide information about tenderers' past performance. These forms should aim at soliciting more comprehensive information, covering specific performance areas (such as responsiveness to requests and compliance with contract conditions).**

In-house performance information

3.8 An effective means to encourage contractors to provide good services is to take into account their past performance when evaluating tenders submitted by them. As stated in LCSD tender documents, a tenderer's performance (as contractor) will be monitored and may be taken into account when the Government evaluates tenders or quotations that he may submit in future.

3.9 Upon enquiry, the LCSD informed Audit in May 2007 that the tender assessment panel mainly relied on performance information submitted by tenderers, while in-house performance information would be used only as supplementary information. **The LCSD needs to ensure that, for tenderers who are its existing or former contractors, their performance in contracts with the LCSD are taken into account in the tender evaluation.**

Audit recommendations

3.10 **Audit has recommended that the Director of Leisure and Cultural Services should:**

- (a) **design forms for inviting tenderers' other clients to provide information about tenderers' past performance, covering more specific areas (such as responsiveness to requests and compliance with contract conditions); and**
- (b) **ensure that, for tenderers who are LCSD existing or former contractors, their performance in contracts with the LCSD are taken into account in the tender evaluation.**

Response from the Administration

3.11 The **Director of Leisure and Cultural Services** accepts the audit recommendations. He has said that the LCSD:

- (a) is devising an effective and efficient means (including the use of a standard form) to solicit comments on tenderers' performance from their referees; and
- (b) will review the internal procedures to ensure that contractors' performance in LCSD contracts could be taken into account in future tenders.

Contractors' obligations before commencement of contracts

3.12 According to LCSD tender procedures, after the relevant authority has approved the award of a contract, the LCSD will issue a letter of acceptance (LOA) to the selected tenderer. The LOA requires the tenderer to submit, within 14 days (i.e. 2 weeks) after the LOA date:

- (a) the contract deposit, which usually takes the form of a bank guarantee;
- (b) a copy of the public liability insurance policy; and
- (c) a copy of the employees' compensation insurance policy.

Audit observations

3.13 Audit selected eight contracts (one contract from each of the eight tender exercises in the audit sample — see para. 3.3) for review to ascertain whether the bank guarantees and insurance policies were submitted on time (see Table 5). Audit found that:

- (a) in six contracts, the selected tenderers did not submit bank guarantees within two weeks after the LOA date; and

- (b) in five contracts, the selected tenderers did not submit copies of the public liability and employees' compensation insurance policies within two weeks after the LOA date.

Table 5

Submission of bank guarantees and insurance policies

Number of weeks after the LOA date	Number of tenderers	
	Bank guarantees	Public liability and employees' compensation insurance policies
0 to 2	2	3
>2 to 4	2	2
>4 to 6	3	3
>6	1 (Note)	—
Total	8	8

Source: Audit analysis of LCSD records

Note: The submission was made ten weeks after the LOA date.

3.14 **Audit considers that the delays in submitting bank guarantees and insurance policies by contractors are not satisfactory.** The LCSD needs to take measures to improve the situation.

3.15 For the eight contracts selected for review, Audit also compared the effective dates of the bank guarantees and insurance policies with the contract commencement dates. The results are as follows:

Bank guarantees

- (a) in five contracts, the effective dates of the bank guarantees were 9 to 52 days after the contract commencement dates;

Employees' compensation insurance policies

- (b) in one contract, the effective date of the employees' compensation insurance policy was nine days after the contract commencement date;

Public liability insurance policies

- (c) in all eight contracts, the effective dates of the public liability insurance policies were either on or before the contract commencement dates; and
- (d) in four contracts, however, the insurance policies were not "exclusively for the contract in the joint names of the Government and the contractor", as required by the tender documents. The LCSD requested the contractors to rectify the situation. As at 31 July 2007:
 - (i) for two contracts, the revised policies (in the joint names of the Government and the contractor) were received 236 and 304 days after the contract commencement dates; and
 - (ii) for the other two contracts, the revised policies were still not received (i.e. 122 and 243 days after the contract commencement dates).

Audit recommendations

3.16 **Audit has recommended that the Director of Leisure and Cultural Services should:**

- (a) **ensure that contractors provide contract deposits and submit copies of insurance policies on time; and**
- (b) **remind contractors to provide public liability insurance policies exclusively for the contracts in the joint names of the Government and the contractor.**

Response from the Administration

3.17 The **Director of Leisure and Cultural Services** accepts the audit recommendations. He has said that:

- (a) regarding paragraph 3.16(a), in order to ensure that contractors can arrange contract deposits and insurance policies on time before contract commencement, the LCSD has advanced the schedule of tender preparation to allow sufficient time for the selected tenderers to prepare and submit relevant documents immediately after the approval from the appropriate tender board is granted; and

- (b) regarding paragraph 3.16(b), the LCSD has recently issued a reminder to all contractors to ensure that the public liability insurance policies must be taken out exclusively for the contract in the joint names of the Government and the contractor.

Market interest in providing sports centre management services

3.18 The LCSD has outsourced the management services of sports centres since 2000. As at July 2007, the management services of 16 sports centres (i.e. 18% of a total of 88 sports centres) were outsourced.

Photograph 3

An LCSD sports centre with management services outsourced



Source: LCSD records

3.19 **Imposing maximum contracting-out price.** In 2003, in order to meet the need of achieving cost savings, the LCSD sought the Central Tender Board's approval to impose a maximum contracting-out price in the tenders for sports centre management services. The maximum contracting-out price, which was stated in the tender documents, would be 75% of the in-house cost of providing the management services. Any tender above this price would not be considered. In September 2003, the Board advised the LCSD to ensure that there would be sufficient competition in the tenders. In November 2003, the Board approved the proposal.

3.20 *Decreasing market interest.* Upon imposing the maximum contracting-out price, the number of tenders received decreased significantly. Before that, the average number of tenders received was about ten per sports centre. Subsequently, for the four tender exercises in the second half of 2004 and 2005, the average number of tenders received was only one to two per sports centre.

3.21 *Efficiency Unit review.* In 2006, the EU carried out a review of the outsourcing activities of the LCSD. The EU considered that the maximum contracting-out price had reduced the market interest to an unacceptably low level. The EU recommended that the LCSD should, among other things:

- (a) review the level of the maximum contracting-out price and, in the long run, examine the need for the maximum contracting-out price; and
- (b) enhance the attractiveness of the contracts. For example, the contractors could be allowed to provide value-added services, such as selling sports goods.

3.22 *Revision of maximum contracting-out price.* In June 2006, the LCSD submitted to the Central Tender Board a proposal to revise the maximum contracting-out price from 75% to 85% of the in-house cost. According to the LCSD, the maximum contracting-out price had to be revised, otherwise the tenders would become unattractive. In August 2006, the Central Tender Board approved the proposal.

Audit observations

3.23 After revising the maximum contracting-out price to 85% of the in-house cost, in the second half of 2006, the LCSD held three tender exercises relating to eight sports centres. Table 6 shows the results of these tender exercises.

Table 6

Results of three tender exercises for sports centre management services

Sports centre	Number of tenders received	Maximum contracting-out price (a) (\$ million)	Actual contract price (b) (\$ million)	Difference	
				(c) = (a) – (b) (\$ million)	(d) = (c) / (a) (%)
<i>Tender Exercise 1 (Contract period: April 2007 to March 2010)</i>					
A	3	8.2	7.7	0.5	6%
B	3	8.3	7.5	0.8	10%
C	3	9.6	8.7	0.9	9%
<i>Tender Exercise 2 (Contract period: May 2007 to April 2010)</i>					
D	3	33.2	29.5	3.7	11%
<i>Tender Exercise 3 (Contract period: May 2007 to April 2010)</i>					
E	3	14.1	12.9	1.2	9%
F	2	9.4	8.8	0.6	6%
G	3	7.8	7.4	0.4	5%
H	4	8.0	7.9	0.1	1%
Overall	24	98.6	90.4	8.2	8%

Source: Audit analysis of LCSD records

3.24 Table 6 shows that, for the three tender exercises:

- (a) the actual contract price was on average 8% **below** the maximum contracting-out price; and
- (b) there were on average three tenders received for each sports centre.

3.25 However, the 24 offers in these three tender exercises came from just four tenderers. **Market interest in tendering for sports centre management services appeared still on the low side. Audit considers that the LCSD needs to take measures to stimulate market interest.** For example, the LCSD could allow contractors to provide value-added services such as selling sports goods (see para. 3.21(b)).

3.26 Audit notes that it is uncommon to impose a maximum contract price in a tender. In September 2003, the Central Tender Board expressed concern that such a practice might result in bids which were close to the maximum contracting-out price. There is a risk that the maximum contracting-out price may become a guiding factor for tenderers to set their bidding prices, thus preventing the LCSD from obtaining a fair market price from a tender exercise. **The LCSD should review the need for the maximum contracting-out price, taking into account market interest in providing sports centre management services.**

Audit recommendations

3.27 **Audit has recommended that the Director of Leisure and Cultural Services should:**

- (a) **ascertain the reasons for the small number of tenderers bidding contracts for sports centre management services;**
- (b) **take measures to make the contracts of sports centre management services more attractive (e.g. allowing contractors to provide value-added services); and**
- (c) **review the need for setting the maximum contracting-out price, taking into account market interest in providing sports centre management services.**

Response from the Administration

3.28 The **Director of Leisure and Cultural Services** accepts the audit recommendations. He has said that the LCSD will maintain the attractiveness of sports centre management service contracts, and review the need for the maximum contracting-out price by taking into account market interest in providing sports centre management services.

Sub-contracting sports centre management services

3.29 According to the contract conditions for the outsourcing of sports centre management services, contractors are allowed to engage sub-contractors if the prior written consent of the Government is obtained.

Audit observations

3.30 As at July 2007, the management services of 16 LCSD sports centres were outsourced to five contractors, at a total contract value of \$165 million. A major contractor (Contractor C) was awarded four outsourcing contracts, amounting to \$117 million (i.e. 71% of \$165 million), covering nine LCSD sports centres.

3.31 In an audit visit to a sports centre managed by Contractor C, Audit noted that the maintenance of sports equipment in the sports centre was sub-contracted to another company. In response to enquiries, the LCSD sports centre management informed Audit that there were similar sub-contracting arrangements in all nine sports centres managed by Contractor C. However, before entering into the sub-contracting arrangements, Contractor C did not seek LCSD approval. As at July 2007, the LCSD had not given written consent to Contractor C for sub-contracting.

3.32 The LCSD needs to remind all outsourcing contractors of sports centre management services to strictly follow the requirement of seeking the prior written consent of the Government before engaging sub-contractors.

3.33 Audit considers that the cases mentioned in paragraph 3.31 may constitute breach of contract. In July 2007, Audit referred these cases to the LCSD senior management for investigation and necessary remedial actions.

Audit recommendations

3.34 **Audit has *recommended* that the Director of Leisure and Cultural Services should:**

- (a) **remind all outsourcing contractors of sports centre management services that they should seek the prior written consent of the Government before engaging sub-contractors; and**
- (b) **investigate the cases of suspected breach of contract by sub-contracting without the prior written consent of the Government, and take necessary remedial actions.**

Response from the Administration

3.35 The **Director of Leisure and Cultural Services** accepts the audit recommendations. He has said that:

- (a) regarding paragraph 3.34(a), the LCSD will continue to remind contractors that prior consent is required for any sub-contracting arrangement, and step up measures to detect any breach of contract; and
- (b) regarding paragraph 3.34(b), for those cases where sub-contracting was arranged without the department's prior consent, the LCSD will apply appropriate sanctions on the defaulted contractor.

Employing people with disabilities

3.36 The LCSD encourages its cleansing service contractors to employ people with disabilities (PWDs). According to the LCSD marking scheme for technical assessment of tenders for cleansing services, marks are awarded to a tenderer who has proposed to employ a specified percentage of PWDs (see Table 7 for details). If the contract is awarded to this tenderer, the proposed percentage of employment of PWDs as workers becomes part of the contract terms. It is therefore a contractual requirement that the successful tenderer should fulfil his commitment to employ PWDs.

Table 7

Marks awarded to tenderers who have proposed to employ PWDs

Previous marking scheme (April 2003 to June 2004)		Current marking scheme (As from July 2004)	
Percentage of PWDs employed	Marks awarded (out of a total of 100 marks)	Percentage of PWDs employed	Marks awarded (out of a total of 100 marks)
40% or more	4	20% or more	4
20% to less than 40%	2		
Less than 20%	0	Less than 20%	0

Source: LCSD marking scheme for cleansing services

3.37 The cleansing service contracts have the following standard provisions to ensure that contractors fulfil their commitments to employ PWDs:

- (a) a tenderer who has proposed to engage PWDs as workers under the contract should provide the list of PWDs engaged if awarded the contract, supported by documentary proof of their disabilities; and
- (b) the contractor shall, prior to the commencement of the contract, provide the LCSD with details of all PWDs to be employed.

Audit observations

Contractors did not fulfil their commitments

3.38 For the three DLSOs and three cultural venues selected for examination (see para. 4.5), Audit asked for information about the number of PWDs employed by the cleansing contractors as at July 2007. The purpose was to see whether the contractors had fulfilled their commitments to employ PWDs (see Table 8).

Table 8

**PWDs employed by cleansing contractors
at DLSOs/cultural venues examined by Audit
(July 2007)**

DLSO/ Cultural venue (Note)	Marks awarded (for employing PWDs) in tender evaluation	Number of all workers (a)	PWDs employed				
			Proposed in the tender		Actual		Shortfall
			(Number)	(Percentage)	(Number)	(Percentage)	(Number)
			(b)	(c) = (b)/(a)	(d)	(e) = (d)/(a)	(f) = (b) – (d)
DLSO I	4	202	41	20%	13	6%	28
DLSO II	4	216	44	20%	28	13%	16
DLSO III	4	156	32	20%	19	12%	13
Venue I	4	27	11	40%	6	22%	5
Venue III	4	74	15	20%	15	20%	—
Overall		675	143	21%	81	12%	62

Source: Audit analysis of LCSD records

Note: Venue II was not included because the contractor did not indicate in his tender that he would employ PWDs.

3.39 Table 8 shows that in three DLSOs and one cultural venue, the cleansing contractors did not fulfil their commitments to employ PWDs. **Audit considers that this may constitute breach of contract.**

Need to submit management plans on the employment of PWDs

3.40 One of the criteria for technical assessment of tenders is the quality of the tenderer's management plan, which should include information such as expertise and qualifications of managerial staff, and details of staff requirements and training programmes. In Audit's view, employing PWDs to a level of 20% or more of the workforce (see Table 7 in para. 3.36) will require thorough management planning on the part of the contractor, for example, on the sourcing, screening, training and supervision of PWDs. **The LCSD needs to consider whether tenderers should explain in detail in their management plans about how they would recruit and retain the proposed workforce of PWDs, and how they would train and assist PWDs in carrying out their work.**

Need to verify fulfilment of commitments to employ PWDs

3.41 In the DLSOs and cultural venues selected for examination, Audit noted that procedures were not in place to verify the number (and percentage) of PWDs employed. LCSD staff of the DLSOs/cultural venues did not ask the contractors to submit lists of PWDs employed for checking, in accordance with the standard provisions of the contracts (see para. 3.37). **Audit considers that the LCSD needs to devise procedures to verify that the cleansing contractors' commitments to employ PWDs are fulfilled throughout the contract period.**

Audit recommendations

3.42 **Audit has recommended that the Director of Leisure and Cultural Services should:**

- (a) **consider whether tenderers need to explain in detail in their management plans about how they would recruit and retain the proposed workforce of PWDs, and how they would train and assist PWDs in carrying out their work; and**
- (b) **devise procedures to verify that the cleansing contractors' commitments to employ PWDs are fulfilled throughout the contract period.**

Response from the Administration

3.43 The **Director of Leisure and Cultural Services** accepts the audit recommendations. He has said that:

- (a) regarding paragraph 3.42(a), the LCSD will revise the tender terms to include a requirement that tenderers should provide details of their recruitment and retention plans for the committed manpower level of PWDs. Meanwhile, the LCSD will remind staff concerned to request the contractors to submit before contract commencement the lists of PWDs engaged under the contracts; and
- (b) regarding paragraph 3.42(b), the LCSD will advise staff concerned to monitor closely throughout the contract period on the contractors' full compliance with their commitments to engage PWDs.

3.44 The **Commissioner for Labour** has said that:

- (a) the marking scheme adopted by the LCSD in outsourcing its cleansing services awards marks to tenderers who propose to employ PWDs. This is a useful means to enhance the employment opportunities of PWDs and consideration should be given to promoting the practice on a service-wide basis; and
- (b) the LD agrees with the need to put in place effective measures to regularly monitor the employment of PWDs by the cleansing contractors, including the recruitment and retention of PWDs. This will help ensure that the contractors fulfil their contractual obligations in respect of employment of PWDs.

3.45 The **Director of Social Welfare** has said that the audit recommendations are agreeable because they are in line with the policy to support and strengthen the employment of PWDs.

Use of outcome-based contracts

3.46 There are two main types of service specifications in outsourcing contracts:

- (a) input-based service specifications, which primarily specify the process inputs and step-by-step procedures; and
- (b) outcome-based service specifications, which primarily specify the desired outputs or outcomes, giving the contractor more flexibility to determine what inputs and procedures are required.

3.47 The Government has been advocating the use of outcome-based service specifications to encourage contractors to propose innovative solutions, focusing on the business outcomes required by outsourcing departments and giving contractors greater flexibility to respond to changing circumstances. For example, the FEHD has started using outcome-based outsourcing contracts for some of its environmental hygiene services (Note 4).

Audit observations

3.48 For cleansing, security, and horticultural maintenance services, the LCSD mainly uses input-based service specifications in its outsourcing contracts. For sports centre management services, both input-based and outcome-based service specifications have been used. Examples of outcome-based service specifications include the following:

- (a) **Facility utilisation.** The utilisation of facilities in the sports centre should increase by agreed percentages (e.g. 5% in the first year);
- (b) **Revenue.** The annual revenue should increase by agreed percentages (e.g. 5% in the first year);
- (c) **Customer satisfaction.** The percentage of satisfied customers in customer satisfaction surveys should increase by agreed percentage points (e.g. 1% in the first year); and
- (d) **Complaints.** The number of substantiated complaints should not be more than four cases in a year.

3.49 Audit notes that the LCSD has started using some outcome-based service specifications, mainly in the outsourcing of sports centre management services. However, there appears to be scope for using more outcome-based service specifications in outsourcing contracts for cleansing, security, and horticultural maintenance services.

Audit recommendation

3.50 **Audit has recommended that the Director of Leisure and Cultural Services should explore the feasibility of using more outcome-based service specifications in LCSD outsourcing contracts.**

Note 4: *In three outcome-based street cleansing contracts awarded by the FEHD in recent years, cost savings of 20% or \$18.5 million were reported.*

Response from the Administration

3.51 The **Director of Leisure and Cultural Services** accepts the audit recommendation. He has said that the LCSD conducts regular reviews on the use of outcome-based specifications in outsourcing contracts. Under the circumstances of the LCSD, both input-based and outcome-based specifications are adopted. Nevertheless, the LCSD will keep exploring opportunities to include more outcome-based specifications in its outsourcing contracts.

PART 4: MONITORING THE PERFORMANCE OF CONTRACTORS

4.1 This PART examines the adequacy of LCSD monitoring of the performance of contractors in the provision of outsourced services.

Background

Staff responsible for monitoring contractor performance

4.2 *Leisure services.* DLSOs oversee the leisure and amenity facilities (e.g. parks, playgrounds, sports centres and swimming pools) in the districts under their purview. A DLSO is headed by a District Leisure Manager (DLM), who is assisted by Deputy DLMs, Assistant DLMs and Managers. These supervisory staff of the Leisure Services Manager grade are assisted by staff of the Amenities Assistant (AA) grade. DLSO staff are responsible for monitoring contractor performance in the provision of outsourced services.

4.3 *Cultural services.* There are three types of cultural venues (i.e. museums, performing arts venues, and libraries), which are headed by officers of the Curator, Cultural Services Manager, and Librarian grades respectively. These officers are assisted by staff of the Cultural Services Assistant (CSA) grade. Cultural venue staff are responsible for monitoring contractor performance in the provision of outsourced services.

Departmental warning system for service contracts

4.4 The LCSD has established a departmental warning system for service contracts for the guidance of venue managers (i.e. staff responsible for overseeing leisure and cultural venues) in monitoring contractor performance. This warning system is described at Appendix C.

Review of the monitoring of contractor performance

4.5 In order to review LCSD monitoring of the performance of outsourcing contractors, Audit visited:

- (a) three DLSOs (referred to as DLSO I, DLSO II and DLSO III) selected from the New Territories, Kowloon, and Hong Kong Island; and
- (b) three cultural venues (one museum, one performing arts venue and one library, and referred to as Venue I, Venue II and Venue III respectively).

4.6 Audit has found that there are a number of areas where improvement can be made in LCSD monitoring of the performance of outsourcing contractors, including:

- (a) daily monitoring (see paras. 4.7 to 4.18);
- (b) supervisory inspections of leisure facilities (see paras. 4.19 to 4.25);
- (c) enhanced supervisory inspections of swimming pools (see paras. 4.26 to 4.30);
- (d) regulatory actions on unsatisfactory performance (see paras. 4.31 to 4.39); and
- (e) assessing the performance of contractors (see paras. 4.40 to 4.46).

Daily monitoring

Leisure facilities and cultural venues

4.7 Leisure facilities in a district are classified into:

- (a) **Major facilities.** These include revenue-generating facilities, district parks, and beaches. They have on-site staff (e.g. AAs) who inspect, on a daily basis, contractor performance (e.g. in providing cleansing and security services); and
- (b) **Minor facilities.** These include sitting-out areas and rest gardens. They normally do not have on-site staff. The AAs responsible for minor facilities patrol, on a daily basis, these facilities to inspect contractor performance.

4.8 For cultural venues, most of them have on-site staff (e.g. the CSAs) who inspect, on a daily basis, contractor performance.

Horticultural sites

4.9 The contractor providing horticultural maintenance services to a district is required to submit to the DLSO monthly and daily work programmes. A monthly programme details the horticultural work (e.g. watering, weeding and pruning) to be carried out in the following month. A daily programme details the work to be carried out on the following day, taking into account weather conditions and DLSO instructions. Based on these programmes, the responsible AAs patrol, on a daily basis, the horticultural sites to inspect contractor performance.

4.10 There are many horticultural sites spreading over a large area in each district. Table 9 shows the horticultural sites under the purview of the three DLSOs visited by Audit.

Table 9

**Horticultural sites under the purview
of the three DLSOs visited by Audit**

DLSO	Number of horticultural sites	Total area (’000 square metres)
I	259	919
II	259	457
III	184	309
Total	702	1,685

Source: LCSD records

Photograph 4

An LCSD horticultural site



Source: LCSD records

Audit observations

4.11 The AAs responsible for patrolling minor leisure facilities and horticultural sites play a significant role in monitoring contractor performance. In a DLSO, each AA is assigned a number of minor leisure facilities and horticultural sites. Based on visits to DLSOs I, II and III, Audit found that there was scope for improvement in a number of areas (see paras. 4.12 to 4.16).

Patrol routes

4.12 The AAs of the three DLSOs patrolled minor leisure facilities and horticultural sites basically according to the monthly and daily work programmes submitted by the contractors. They determined their own patrol routes, without seeking their supervisors' prior approval. It was therefore difficult for their supervisors to ensure that the coverage of the patrol routes was adequate (e.g. whether all the minor facilities and horticultural sites would be adequately covered).

4.13 In view of the large area to be covered (see Table 9 in para. 4.10), it is more effective to adopt a risk-based approach in determining the patrol routes, taking into account complaints, problem areas identified, and other relevant factors. **Audit considers it necessary for the supervisors of the AAs to check and approve the patrol routes to ensure an adequate coverage of the minor facilities and horticultural sites in the districts.**

Conditions of horticultural sites

4.14 In performing the patrol duties, the AAs of the three DLSOs were not required to record the general conditions of horticultural sites. Therefore, the DLSOs had little information to assess the monthly work programmes provided by outsourcing contractors, and to determine whether the types of work proposed by the contractors were appropriate. **To ensure resources are used effectively, the LCSD may devise a standard inspection form for the AAs to report on the conditions of horticultural sites, in order to obtain information for assessing the monthly work programmes submitted by the contractors.**

Inspection reports

4.15 The AAs responsible for the monitoring of contractor performance mainly perform outdoor patrol duties on a daily basis. According to Civil Service Bureau Circular No. 11/99 "*Guidelines on Supervision of Outdoor Duties*", arrangement should be made for outdoor staff to report on the work they have done (e.g. staff may be required to keep records of the work, such as nature, location, time spent, results, etc.). Audit noted that

the AAs of DLSO I were required to prepare weekly reports on their daily inspection work, while the AAs of DLSOs II and III were not required to do so. **Audit considers that the LCSD needs to ensure that all AAs prepare reports on their daily inspection work.**

Spot checks by supervisors

4.16 According to the Guidelines mentioned in paragraph 4.15, regular and random spot checks by supervisors can ensure proper attendance and performance of outdoor duties, especially if the duties are at remote locations, done at irregular hours, or with no visible output (e.g. patrol duties). However, no spot checks were conducted by the supervisors on the work of the AAs in the three DLSOs visited by Audit. **The LCSD needs to consider putting in place a system of spot checking by supervisors.**

Audit recommendations

4.17 **Audit has recommended that the Director of Leisure and Cultural Services should:**

- (a) **require that the patrol routes of the AAs are checked and approved by their supervisors;**
- (b) **devise a standard inspection form for the AAs to report on the general conditions of horticultural sites, in order to obtain information for assessing the monthly work programmes submitted by the contractors;**
- (c) **ensure that the AAs prepare reports on their daily inspection work; and**
- (d) **consider putting in place a system of spot checking by supervisors.**

Response from the Administration

4.18 The **Director of Leisure and Cultural Services** accepts the audit recommendations. He has said that:

- (a) regarding paragraph 4.17(a), the LCSD will implement shortly the requirement for the pre-approval of AAs' patrol routes by their supervisors. Owing to operational needs, the AAs will be allowed to adjust the approved routes when necessary and report the adjustments to their supervisors afterwards;

- (b) regarding paragraph 4.17(b) and (c), the LCSD will revise the current inspection report forms so that they could also be used for checking minor leisure facilities. The LCSD will streamline the reporting system so that the AAs can record their observations in a succinct manner; and
- (c) regarding paragraph 4.17(d), supervisors of AAs will conduct random spot checking.

Supervisory inspections of leisure facilities

4.19 In accordance with the LCSD Guidelines on the Inspection System for Leisure Facilities (Inspection Guidelines), supervisory staff of the DLSOs should carry out supervisory inspections on leisure facilities of the districts under their purview. One of the objectives of these inspections is to check the performance of contractors. The Inspection Guidelines provide standard inspection forms and guidelines (including the inspection frequencies for DLSO supervisory staff — see Table 10).

Table 10
Inspection frequencies for DLSO supervisory staff

Supervisory staff	Inspection frequency	
	Major leisure facilities	Minor leisure facilities
DLM	Once in 6 months	Once a year
Deputy DLM	Once in 4 months	Once in 8 months
Assistant DLM	Once in 4 months	Once in 8 months
Manager	Once a month	Once in 2 months
Senior AA	Once a month	Once in 2 months
AA I	Once in 2 weeks	Once a month

Source: LCSD Inspection Guidelines

Audit observations

4.20 Audit selected three major leisure facilities from each of the three DLSOs (see para. 4.5) to examine whether supervisory inspections were conducted in accordance with the Inspection Guidelines, for the period October 2005 to March 2007. **Audit found that most of the supervisory staff of the nine selected major leisure facilities did not document on file that they had conducted the required number of supervisory inspections stipulated in the Inspection Guidelines.** According to LCSD records, for these nine major leisure facilities, the overall attainment of the required number of supervisory inspections was only 22%.

4.21 In response to enquiries, the LCSD informed Audit in September 2007 that the DLSO supervisory staff did conduct regular visits to the major leisure facilities, but they might not have prepared inspection reports for some of these visits. The LCSD further explained that:

- (a) owing to the large number of leisure facilities and the need to meet different operational requirements, DLSO supervisory staff might not be able to complete inspection reports in accordance with the Inspection Guidelines every time during their supervisory inspections;
- (b) instead, they usually put down their inspection findings/observations on different types of records/forms (e.g. occurrence books, staff attendance books, worker interview records, incident reports, and notebooks of the AAs); and
- (c) some officers might not sign on the inspection report forms/books if everything was found to be in order during the inspections and no follow-up action was necessary.

4.22 Audit notes that the Inspection Guidelines provide clear guidelines and detailed checklists to help supervisory staff conduct their inspections effectively. The Inspection Guidelines also provide for the use of a standard inspection report form, which sets out areas to be inspected and facilitates clear documentation of observations and actions taken/required. Given the different types of records/forms used by DLSO supervisory staff to document their inspection results (see para.4.21(b)), there is no system in place to ensure that the required supervisory inspections are properly carried out in accordance with the departmental guidelines. **The LCSD needs to ensure that DLSO supervisory staff carry out supervisory inspections and document the inspection results properly, in accordance with the Inspection Guidelines.**

4.23 Regarding supervisory inspections of minor leisure facilities, the supervisory staff at the three DLSOs (see para. 4.5) informed Audit in May and June 2007 that they conducted supervisory inspections but might not have prepared inspection reports. **Audit considers that inspection reports for supervisory inspections of minor leisure facilities should also be prepared.**

Audit recommendation

4.24 **Audit has recommended that the Director of Leisure and Cultural Services should ensure that supervisory inspections of both major and minor leisure facilities are carried out, and inspection results are properly documented, in accordance with the Inspection Guidelines.**

Response from the Administration

4.25 The **Director of Leisure and Cultural Services** accepts the audit recommendation. He has said that:

- (a) the Inspection Guidelines have highlighted specific areas that district managers, supervisors and front-line staff should pay special attention to when conducting inspections, including staff attendance and discipline, provision of services, maintenance of play equipment, etc.;
- (b) the LCSD will revise the existing Inspection Guidelines to include appropriate inspection report forms on minor leisure facilities and horticultural sites for use by the AAs and supervisory staff; and
- (c) since the risk levels of major and minor leisure facilities are different, the LCSD will adopt a risk-based approach in determining the inspection frequency and scope for different venues.

Enhanced supervisory inspections of swimming pools

4.26 In order to improve the hygiene and cleanliness of swimming pools, in September 2005 the LCSD revised the Inspection Guidelines such that more frequent and thorough supervisory inspections of swimming pools would be required. Table 11 shows the revised inspection frequencies for swimming pools.

Table 11

**Revised inspection frequencies for swimming pools
(as from September 2005)**

Supervisory staff	Inspection frequency
Chief Leisure Manager	Once a month
DLM/Deputy DLM (Note)	Once a week
Assistant DLM	Once a week

Source: LCSD records

Note: Deputy DLMs can conduct supervisory inspections on swimming pools, on behalf of the DLMs.

Audit observations

4.27 For the three DLSOs under examination (see para. 4.5), Audit selected four swimming pools to ascertain whether supervisory inspections were conducted in accordance with the revised Inspection Guidelines, for the period October 2005 to March 2007. **Audit found that most of the supervisory staff of the four selected swimming pools did not conduct the required number of inspections.** For these four swimming pools, the overall attainment of the required number of supervisory inspections was 79%.

4.28 In response to enquiries, the LCSD informed Audit in September 2007 that the actual frequencies of inspections of swimming pools could not fully meet those recommended in the departmental guidelines, mainly because of heavy workload. The LCSD considered that the inspection frequencies recommended in the departmental guidelines, especially during winter months, would need to be reviewed.

Audit recommendations

4.29 **Audit has recommended that the Director of Leisure and Cultural Services should:**

- (a) **review LCSD departmental guidelines on the enhanced supervisory inspections of swimming pools, taking into account latest assessments of the hygiene and cleanliness of the swimming pools; and**

- (b) **pending completion of the review, ensure that supervisory inspections of swimming pools are carried out and inspection reports are prepared in accordance with the departmental guidelines.**

Response from the Administration

4.30 The **Director of Leisure and Cultural Services** accepts the audit recommendations. He has said that the LCSD will review the guidelines on the enhanced supervisory inspections of swimming pools, particularly on the inspection frequencies during the winter season.

Regulatory actions on unsatisfactory performance

4.31 LCSD staff in DLSOs and cultural venues take regulatory actions on unsatisfactory performance of contractors mainly by issuing regulatory instruments. They may do so by issuing advisory letters (ALs), DNs and warning letters (WLs) — see Appendix C. In addition, LCSD staff in DLSOs and cultural venues may issue:

- (a) *Verbal warnings.* These are normally issued by LCSD front-line staff to contractor staff on the spot. For example, an AA or a CSA may issue a verbal warning to a cleansing worker asking him to clean a toilet; and
- (b) *Notices of unsatisfactory services (NUSs).* These are normally issued by venue managers to supervisory staff of contractors, informing them of unsatisfactory performance, and asking them to make improvements as soon as possible. NUSs are used by the Leisure Services Branch, but not the Cultural Services Branch.

Audit observations

4.32 Audit examined the regulatory actions taken by staff of the DLSOs and cultural venues selected for review (see para. 4.5) during the period April 2005 to June 2007, and found that there was scope for improvement in some areas (see paras. 4.33 to 4.37).

No or late regulatory actions

4.33 Audit noted that LCSD staff in DLSOs and cultural venues, in some instances, did not take regulatory actions, although such actions were warranted. In some other instances, they did not take regulatory actions in a timely manner. For illustration, see Cases 1 and 2 below.

Case 1

At Venue II (a performing arts venue), the cleansing service contractor allowed his staff to work more than 26 days a month on a few occasions since contract commencement in June 2006. These were breaches of the contract condition that the maximum number of allowable working days per month was 26. However, LCSD staff in Venue II accepted the contractor's explanation that there were operational needs, and did not take regulatory action on the breaches. **Audit considers that LCSD staff in Venue II could have taken regulatory actions (e.g. by issuing an AL or a DN (General)).**

Case 2

At DLSO I, the security service contractor did not submit staff employment contracts within 14 days of the contract commencement date in August 2005. After three months, LCSD staff in DLSO I issued an AL. The contractor subsequently submitted the staff employment contracts. **Audit considers that LCSD staff in DLSO I could have issued an AL or a DN (General) to the contractor earlier.**

Source: LCSD records

4.34 It is important that staff of user sections take timely and appropriate regulatory actions. **The LCSD needs to provide clear guidelines and training to user sections on how to use regulatory instruments properly.**

Regulatory actions not commensurate with seriousness of breaches

4.35 It appeared that the staff of DLSOs and cultural venues usually adopted relatively lenient measures. In particular, they tended to use NUSs, instead of ALs and DNs. Three case studies (Cases 3 to 5) are shown below.

Case 3

At DLSO I, the security service contractor allowed a guard to work nine hours a day in four instances in May 2007. This breached the contract condition that the maximum number of allowable working hours per day was eight. The staff of DLSO I issued an NUS to the contractor. **Audit considers that the staff of DLSO I could have taken more stringent regulatory actions (e.g. by issuing a DN under the DPS).**

Case 4

At DLSO I, the horticultural maintenance service contractor did not follow the DLSO instructions to water roadside plants in April 2006. DLSO I had to deploy LCSD staff to water the plants. In May 2006, the staff of DLSO I issued an NUS to the contractor. **Given the relatively serious nature of this breach, Audit considers that the contractor could have been issued a DN (General).**

Case 5

At DLSO III, the horticultural maintenance service contractor persistently performed unsatisfactorily from July 2005 (contract commencement) to December 2005. The staff of DLSO III issued more than 100 NUSs during the period. However, they did not issue any DN(General) to the contractor. **To deal with such cases of repeated defaults, Audit considers that the staff of DLSO III could have escalated regulatory actions by issuing DNs (General).**

Source: LCSD records

4.36 The circumstances underpinning the issuing of NUSs and ALs are not clearly defined. As can be seen in Cases 3 to 5, DLSO staff used NUS, which was the most commonly-used regulatory instrument. Table 12 shows the different types of regulatory instruments issued for the period April 2005 to March 2007.

Table 12

**Regulatory instruments issued by DLSOs/cultural venues examined by Audit
(April 2005 to March 2007)**

Regulatory instrument	DLSOs			Cultural venues			Total
	I	II	III	I	II	III	
Verbal warning	17	0	21	10	12	0	60
NUS	59	109	278	— (Note)	— (Note)	— (Note)	446
AL	0	37	5	9	4	0	55
DN	0	3	5	0	0	0	8
Total	76	149	309	19	16	0	569

Source: Audit analysis of LCSD records

Note: NUSs are not used by the Cultural Services Branch (see para. 4.31(b)).

4.37 Using regulatory instruments properly helps the monitoring of contractor performance. **The LCSD needs to review the use of NUSs and, based on the results of the review, provide clear guidelines on the use of NUSs.**

Audit recommendations

4.38 **Audit has recommended that the Director of Leisure and Cultural Services should:**

- (a) **provide clear guidelines and training to user sections on how to use regulatory instruments properly; and**
- (b) **review the use of NUSs and, based on the results of the review, provide clear guidelines on the use of NUSs.**

Response from the Administration

4.39 The **Director of Leisure and Cultural Services** accepts the audit recommendations. He has said that:

- (a) seminars and workshops on contract management are conducted regularly by the Training Section and Supplies Section of the LCSD to equip officers, who are involved in contract management, with the necessary knowledge; and
- (b) the LCSD will review the use of NUSs, and devise clear guidelines on using regulatory instruments (including NUSs) properly.

Assessing the performance of contractors

System for assessing contractor performance

4.40 In the Leisure Services Branch, a contractor's performance is assessed on both monthly and half-yearly bases. In doing so, DLSO staff prepare a monthly assessment report, a copy of which will be given to the contractor for information. Every six months, DLSO staff prepare a half-yearly assessment report, based on the monthly assessment reports in the period concerned.

4.41 In the Cultural Services Branch, a contractor's performance is assessed only on a half-yearly basis. In doing so, cultural venue staff prepare a half-yearly assessment report, based on information gathered during the period concerned.

4.42 The LCSD uses standard forms for its monthly assessment reports and half-yearly assessment reports, which cover the following aspects of performance:

- (a) quality of services;
- (b) observance of contract terms and conditions;
- (c) staff turnover;
- (d) others (which need to be specified if applicable); and
- (e) overall performance.

Audit observations

Need for the Cultural Services Branch to prepare monthly assessment reports

4.43 In the Leisure Services Branch, DLSO staff prepare monthly assessment reports and forward copies of these reports to the contractors informing them of their performance. Audit considers that it is a good practice that can provide contractors with timely feedback, thus enabling them to make necessary improvements as soon as possible. **The Cultural Services Branch of the LCSD may consider also adopting such a practice.**

Need to prepare overall assessment reports for contracts covering several DLSOs/cultural venues

4.44 If an outsourcing contract covers services provided to several DLSOs or cultural venues, staff of the DLSOs or cultural venues will prepare separately their assessment reports on the contractor performance. There is no consolidation of these assessment reports to give an overall assessment report on the contractor performance. Lack of management information on the overall performance of contractors may affect the usefulness of in-house information for evaluating tenders submitted by existing or former LCSD contractors (see also paras. 3.8 and 3.9). **The LCSD needs to prepare an overall assessment report for a contractor that provides services to several DLSOs or cultural venues. The LCSD may take into account this requirement in future enhancement of its computerised contractor performance assessment system (which is now at the late stage of system implementation).**

Audit recommendations

4.45 **Audit has recommended that the Director of Leisure and Cultural Services should:**

- (a) **for contractors of the Cultural Services Branch, consider introducing the practice of preparing monthly assessment reports;**
- (b) **prepare an overall assessment report for each contractor who provides services to several DLSOs or cultural venues; and**
- (c) **take into account the requirement of preparing overall assessment reports for the contractors (see (b) above) in future enhancement of the LCSD computerised contractor performance assessment system.**

Response from the Administration

4.46 The **Director of Leisure and Cultural Services** accepts the audit recommendations. He has said that:

- (a) regarding paragraph 4.45(a), the Cultural Services Branch will adopt the practice of more frequent assessment on contractor performance ; and
- (b) regarding paragraph 4.45(b) and (c), the LCSD will include the requirement of preparing overall assessment reports on contractor performance in future enhancement of its computerised contractor performance assessment system.

PART 5: PERFORMANCE MANAGEMENT AND CONTINGENCY PLANNING

5.1 This PART examines LCSD performance management and contingency planning for its outsourcing contracts.

Effectiveness of outsourcing

Cost savings achieved by outsourcing

5.2 In 2003, the LCSD conducted a survey on the cost savings achieved by outsourcing cleansing, security, and horticultural maintenance services for the year 2002. Table 13 shows the results of the survey.

Table 13

Estimated cost savings achieved by LCSD outsourcing in 2002

Type of services	Estimated savings
Cleansing	42.1%
Security	44.4%
Horticultural maintenance	37.1%
Overall	41.8%

Source: LCSD 2003 survey

5.3 Regarding the outsourcing of sports centre management services, the LCSD has imposed a maximum contracting-out price in order to meet the need of achieving cost savings (see para. 3.19).

Quality of services

5.4 The LCSD has not conducted user satisfaction surveys on the quality of cleansing, security, and horticultural maintenance services provided by contractors. Regarding the outsourcing of sports centre management services, the LCSD has since 2004

conducted annual surveys to collect user opinions on the quality of services provided by contractors. According to these annual surveys, sports centre users were generally satisfied with the quality of services.

Audit observations

5.5 In order to ensure that outsourcing is cost-effective, the LCSD needs to conduct regular user satisfaction surveys, not only for sports centre management services, but also for the other three major types of outsourced services (i.e. cleansing, security, and horticultural maintenance services).

Audit recommendation

5.6 Audit has *recommended* that the Director of Leisure and Cultural Services should, for all major types of outsourced services, conduct regular user satisfaction surveys on the quality of services provided by contractors.

Response from the Administration

5.7 The Director of Leisure and Cultural Services accepts the audit recommendation. He has said that the LCSD:

- (a) collects regularly users' views on their satisfaction on the cleanliness and security services at cultural venues through customer liaison meetings and audience surveys; and
- (b) agrees that user satisfaction surveys are a useful tool to review how services could be improved, and the LCSD will assess the coverage and frequency of user satisfaction surveys.

Performance measurement and reporting

5.8 A government department should systematically measure and report its performance. This can help enhance its performance, transparency and accountability. The LCSD has reported its outsourcing activities in its annual reports, which provide the following information:

- (a) major types of outsourced services;

- (b) extent of outsourcing (e.g. the number of contracts and the total contract value);
and
- (c) efforts in dealing with employment-related irregularities.

Audit observations

5.9 The LCSD has stated in its annual reports that the main objective of outsourcing is to enhance the efficiency of the department and achieve savings. However, the LCSD has not provided performance information regarding the efficiency gains and savings achieved by outsourcing.

5.10 The LCSD needs to devise suitable performance indicators to measure the efficiency gains and savings achieved by outsourcing major types of services, and report such performance information in its annual reports. In order to enhance transparency and accountability, the LCSD also needs to consider including such performance information in its Controlling Officer's Reports.

Audit recommendations

5.11 **Audit has recommended that the Director of Leisure and Cultural Services should:**

- (a) **devise suitable performance indicators to measure the efficiency gains and savings achieved by outsourcing major types of services, and report such performance information in LCSD annual reports; and**
- (b) **consider including such performance information in LCSD Controlling Officer's Reports.**

Response from the Administration

5.12 The **Director of Leisure and Cultural Services** accepts the audit recommendations. He has said that:

- (a) it is the Administration's policy to contain the size of the Government and that only work that has to be performed by civil servants should be done by civil servants;

- (b) most of the outsourced services such as cleansing, security and horticultural maintenance services can no longer be provided by civil servants due to the policy, the change of job descriptions to meet operational needs of the LCSD, and the fading out of some grades in the civil service (e.g. property attendant); and
- (c) the LCSD will review the objectives of outsourcing and devise suitable performance indicators to measure efficiency gains and savings achieved where appropriate and practicable.

Contingency planning

5.13 The LCSD manages a wide range of leisure facilities and cultural venues, and organises diversified recreational activities and cultural programmes. The outsourcing of services in the LCSD covers both its core services (e.g. horticultural maintenance and sports centre management services) and supporting services (e.g. cleansing and security services). Irrespective of whether these services are provided in-house or through outsourcing, the responsibility for the effective provision of services rests with the LCSD. There is a risk that unsatisfactory performance of contractors may affect the overall delivery of services. This risk may be addressed by way of contingency planning.

Contingency plans of contractors

5.14 For the four major types of outsourced services, tenderers are required to submit contingency plans. Taking horticultural maintenance services as an example, the tenderers' contingency plans should include:

- (a) the provision of support and resources at time of emergency, including workers that could be mobilised within a specified timeframe;
- (b) a risk management plan in case of sudden outbreak of incidents, such as breakdown of electricity supply, injury, accident, or gas leakage; and
- (c) the provision of emergency and complaint hotlines.

5.15 The quality of a tenderer's contingency plan is one of the criteria for technical assessment in tender evaluation. It accounts for 12% of the technical score (for cleansing, security, and horticultural maintenance services), and 9% (for sports centre management services). In assessing the contingency plan of a tenderer, there are four ratings (see Table 14 for details). If the tenderer gets the lowest rating (fourth rating) for his contingency plan, he does not meet the technical assessment requirements and therefore is not eligible for the award of contract.

Table 14

Marking scheme for contingency plans submitted by tenderers

Rating	Contingency plan	
	Cleansing, security, and horticultural maintenance services	Sports centre management services
1st	Professional, highly feasible and practicable	Provides information with detailed explanations on the items specified in the tender and other good suggestions
2nd	More than acceptable, generally feasible and practicable	Provides information with detailed explanations on the items specified
3rd	Acceptable	Provides information with brief account on the items specified
4th	Unacceptable	Does not provide all information on the items specified

Source: LCSD records

Audit observations

Ratings of contingency plans of contractors

5.16 For the eight contracts selected for audit examination (see para. 3.13), Audit ascertained the ratings of the contingency plans of the successful tenderers. In general, good ratings were given to these contingency plans in the tender evaluations (see Table 15 for details).

Table 15

Ratings of the contingency plans of successful tenderers

Rating	Number of contracts (out of 8 contracts examined)
1st	3
2nd	3
3rd	2
Total	8

Source: LCSD records

Need for a departmental contingency plan

5.17 The contractors' contingency plans mainly deal with the provision of services in emergency situations (e.g. when there is a typhoon). In order to address the risks of service disruptions due to failure of outsourcing contractors to provide services (e.g. because of bankruptcy), there is a need for an overall contingency plan at the departmental level. These risks need to be properly managed, taking into account the following factors:

- (a) **Risks due to reliance on major contractors.** Among LCSD contractors, there are a number of major contractors who provide services to many leisure districts or cultural venues. If a major contractor does not provide services (e.g. because of bankruptcy), many leisure districts or cultural venues will be affected at the same time, resulting in large-scale service disruptions;
- (b) **Risks due to weak financial position of contractors.** Many LCSD contractors failed the financial vetting conducted during tender evaluation, and were required to pay a contract deposit of 5% of the contract value to mitigate the risk of financial loss to the Government in the event of failure of the contractors; and
- (c) **Risks due to poor track record of employment-related performance.** As at July 2007, seven LCSD contractors had received demerit points under the service-wide DPS (see para. 2.8). These contractors had 32 contracts with the LCSD, with a total contract value of \$861 million (i.e. 46% of the value of all LCSD outsourcing contracts). There is a risk of service disruption following termination of contracts due to poor employment-related performance of contractors.

5.18 Audit notes that the LCSD does not have a departmental contingency plan in place to address the risks mentioned in paragraph 5.17. To terminate a contract, the LCSD would prepare an ad hoc contingency plan. The most recent termination of contract took place in January 2007, in which the LCSD terminated four security service contracts with a contractor, who had financial difficulties and assigned the benefits of the contracts without LCSD prior written consent. Audit noted that the ad hoc contingency plan prepared in this case consisted of the following parts:

- (a) **Termination of contracts.** The LCSD would terminate the contracts according to the terms and conditions of the contracts and with the advice of the Department of Justice;
- (b) **Interim measures.** The LCSD would procure security services for the three months following termination of the contracts, by means of the direct purchase authority (i.e. obtaining quotations and awarding contracts to service providers with the lowest quotations); and
- (c) **Replacement contracts.** The LCSD would conduct a tender exercise for the provision of services to the affected leisure districts and cultural venues.

5.19 Audit considers it desirable for the LCSD to prepare a departmental contingency plan to address the risks of service disruptions due to failure of outsourcing contractors to provide services.

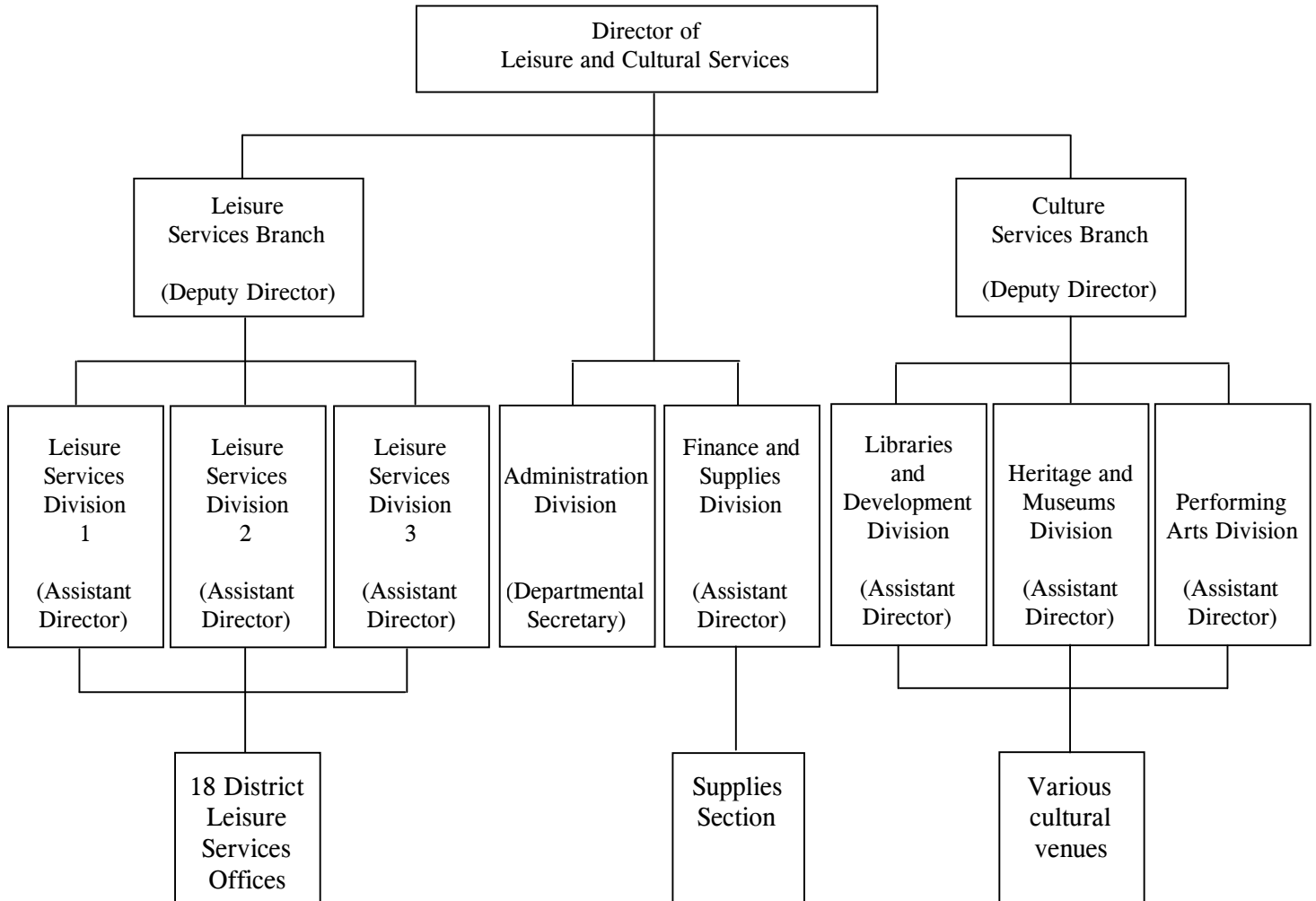
Audit recommendation

5.20 **Audit has recommended that the Director of Leisure and Cultural Services should consider preparing a departmental contingency plan, in order to address the risks of service disruptions due to failure of outsourcing contractors to provide services.**

Response from the Administration

5.21 The **Director of Leisure and Cultural Services** accepts the audit recommendation. He has said that the LCSD will prepare a departmental contingency plan with reference to the experience gained from past contract termination cases, in order to address the risks of possible service disruptions.

**Organisation chart of the LCSD
(July 2007)**



Source: LCSD records

Government measures to protect non-skilled workers

The Government implemented the following key measures to protect non-skilled workers in recent years:

- (a) Financial Circular (FC) No. 3/2004 of March 2004 stipulated:
- (i) **a mandatory requirement for tender assessment, whereby a tender offer should not be considered if, during the 12-month period prior to the tender closing date, the tenderer has had a total of three or more convictions under the relevant ordinances, including:**
- conviction (e.g. for failure to grant any holiday or maternity leave) under the Employment Ordinance (Cap. 57) and the Employees' Compensation Ordinance (Cap. 282) which carries a maximum fine corresponding to Level 5 (\$50,000) or higher of Schedule 8 to the Criminal Procedure Ordinance (Cap. 221);
 - conviction under section 17I(1) of the Immigration Ordinance (Cap. 115) — employing a person who is not lawfully employable;
 - conviction under section 89 of the Criminal Procedure Ordinance and section 41 of the Immigration Ordinance — aiding and abetting another person to breach his condition of stay; and
 - conviction under section 38A(4) of the Immigration Ordinance — the construction site controller employs a person who is not lawfully employable to work on a construction site; and
- (ii) **the implementation of a service-wide Demerit Point System (DPS), under which a contractor will be issued a default notice (DN) which will attract one demerit point, if he has breached his contractual obligations in respect of wages, working hours, and signed written contracts with employees.** A DN will be issued for each breach of these contractual obligations. Different government departments provide information on demerit points allocated to contractors to the Government Logistics Department, which publishes such information on the Government Intranet for sharing by departments. A tender offer should not be considered if during the four most recent quarters before the tender closing date, the tenderer has received from one or more departments a total of six demerit points;

- (b) FC No. 5/2004 of May 2004 (Note) stipulated **a mandatory requirement on wage level to ensure that the wages offered by government service contractors are not lower than the market rates.** As a mandatory requirement for tender assessment, a tender offer shall not be considered if the monthly wages for the non-skilled workers to be employed by the tenderer are less than the average monthly wages for the relevant industry/occupation as published in the latest Census and Statistics Department's Quarterly Report of Wage and Payroll Statistics at the time when tenders are invited;
- (c) on 29 April 2005, the Financial Services and the Treasury Bureau (FSTB) promulgated the mandatory requirement of using a **standard employment contract** to set out clearly the employment terms and conditions. Contractors who breach the terms and conditions in the standard employment contract will be subject to legal sanctions or the DPS under FC No. 3/2004. **For breaches of other terms and conditions in the standard employment contract, the FSTB has stipulated that procuring departments should issue DNs (not under the DPS) to the contractor in accordance with the terms of the service contracts.** Such DNs, though not attracting demerit points, will be taken into account by the department when the contractor concerned bids for tenders for relevant service contracts of the department in future; and
- (d) in FC No. 4/2006 of April 2006, the FSTB promulgated the following tightened measures:
- (i) **if a tenderer has obtained any conviction on or after 1 May 2006, his tender will not be considered for a period of five years from the date of conviction.** Apart from the ordinances mentioned in (a)(i) above, conviction under the Mandatory Provident Fund Schemes Ordinance (Cap. 485) will also be counted for the purpose of tender evaluation;
 - (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 DPS) obtained on or after 1 May 2006 from one or more government departments that use service contractors, his tender will not be considered for a period of five years from the date the third demerit point is obtained;**
 - (iii) a service contract shall be terminated if the contractor has obtained any conviction under the relevant ordinances or three demerit points over a rolling period of three years arising from the same contract; and
 - (iv) wage payment should be made by autopay and the DPS is extended to cover breaches of contractual obligations in respect of wage payment by autopay.

Source: FCs and guidelines issued by the FSTB

Note: This superseded FC No. 3/2001 which had stipulated that, effective from May 2001, government departments should evaluate tenderers' proposed wage levels against market rates. They should also require the successful tenderer to sign written contracts with his employees.

LCSD departmental warning system for service contracts

The LCSD departmental warning system has the following main elements:

- (a) venue managers should monitor contractor performance in accordance with the terms and conditions of the contracts throughout the contract periods and discuss work plans with contractors during routine meetings;
- (b) **Advisory letter.** As soon as it becomes apparent that any performance aspect of a contractor is less than satisfactory or deteriorating, depending on the severity of the default and other relevant factors (e.g. repeated defaults), the venue manager should:
 - (i) draw this to the attention of the contractor in writing, using an advisory letter (AL);
 - (ii) require the contractor to represent himself for the unsatisfactory performance; and
 - (iii) ask the contractor to make improvement;
- (c) **Default Notice.** If there is no improvement after the issue of an AL, the venue manager should consider issuing a default notice (DN). There are three types of DNs:
 - (i) **DNs under the service-wide DPS.** These are issued for four kinds of breaches, i.e. breaches relating to wages, daily maximum working hours, signing of standard employment contracts, and wage payment by means of autopay;
 - (ii) **DNs relating to the standard employment contract.** These are issued for breaches of provisions of the standard employment contract; and
 - (iii) **DNs (General).** These are issued for other breaches, mainly relating to the performance of services;
- (d) **Warning letter.** If the contractor continues to perform below standard or there are major non-compliances, the venue manager should refer the case to the Supplies Section for review and appropriate follow-up actions, which may include the issue of a warning letter (WL). Any contractor who has received a WL will be debarred from tendering for LCSD contracts for a period of 12 months; and
- (e) **Termination of contract.** If there is still no improvement, the LCSD may terminate the contract.

Source: LCSD records

Acronyms and abbreviations

AA	Amenities Assistant
ALs	Advisory letters
Audit	Audit Commission
CPA	Certified Public Accountant
CSA	Cultural Services Assistant
DLM	District Leisure Manager
DLSOs	District Leisure Services Offices
DN	Default notice
DPS	Demerit Point System
EU	Efficiency Unit
FC	Financial Circular
FEHD	Food and Environmental Hygiene Department
FSTB	Financial Services and the Treasury Bureau
HD	Housing Department
LCSD	Leisure and Cultural Services Department
LD	Labour Department
LOA	Letter of acceptance
MPF	Mandatory Provident Fund
NUSs	Notices of unsatisfactory services
PWDs	People with disabilities
WLs	Warning letters