

Chapter 18

Public Works and Government Services Canada

Alternative Forms of Delivery:
Contracting for Property
Management Services

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Public Works and Government Services Canada

Alternative Forms of Delivery: Contracting for Property Management Services

Main Points

18.1 The contracting process used by Public Works and Government Services Canada (PWGSC) to contract out the operation and maintenance of two thirds of its buildings was well managed and consistent with the objectives of the Department. We found that the bidding process was open, transparent and fair. The contracts were well designed and the handover to the contractor went smoothly. A significant feature of the contracting process was the use of “fairness monitors” to provide independent assurance to the Department’s senior management that the process was conducted fairly and in accordance with the rules.

18.2 Because some of the key monitoring and control features were not in place at the time of the handover of operations, ongoing management of the contracts has been problematic. Important items that had to be ready at contract signing — such as budgets for the first year, assessments of building condition and performance indicators of tenant satisfaction — were not completed until well into the first year. As a result, the Department will not be able to carry out a complete assessment of the contractor’s performance in the first year and thereby get full assurance that it is receiving the quality and quantity of service to which it is entitled.

Background and other observations

18.3 Public Works and Government Services Canada, through its Real Property Services Branch (RPS), is the primary landlord of a significant proportion of the government’s real property holdings. Its inventory amounts to about 6 million square metres of space — from office buildings, laboratories and warehouses to the Parliament buildings and other “national treasures”. It also administers 3,000 leases representing annual rent of \$550 million. This makes the Branch one of the largest property managers in the country.

18.4 In 1996, the Department embarked on an initiative called “Alternative Forms of Delivery” (AFD). A key element of the initiative was to contract out the management and operations of a portfolio of buildings, including services ranging from cleaning and the operation of building systems to maintenance, landscaping and repair projects. This initiative was a response to the government’s 1994 Program Review and served as a strategy for restructuring the Branch around its core business activities. The Branch also wanted to support the Canadian property management industry and reduce costs through this initiative.

18.5 The Department contracted out to the private sector the operations and maintenance of approximately 300 buildings with about 2.3 million square metres of office space. It expects to achieve about \$20 million annually in cost savings by turning over the management of those buildings to the private sector.

18.6 The buildings were regrouped by region and offered to the private sector in 13 separate contracts, with a total value of around \$170 million. The same contractor won each of the 13 contracts. It offered jobs to almost all affected employees at full salary for a minimum of three years. About 465 employees accepted the transfer to the contractor.

18.7 It is too early to assess whether savings the Department expects from this initiative will be achieved. We cannot measure at this time whether the Department will receive services at least equal to those it provided itself, and receive them at lower cost. However, mechanisms were incorporated in the contracts that are conducive to achieving savings. We will follow up on these issues in future audit work.

18.8 We encourage Public Works and Government Services Canada to continue to use “fairness monitors” for large and complex contracts. In a project of this scope and complexity, we did not expect to find that all contractual requirements would be fulfilled by the handover date. We did expect that the Department would have established an action plan to deal with the uncompleted deliverables. We have recommended that it develop an action plan with the contractor to deal with outstanding contractual issues, including target completion dates and respective responsibilities for resolving them.

The Department has agreed with our recommendation.

Introduction

18.9 One of the objectives of the government's 1994 Program Review was to "get government right". An important element of this was identifying government activities that might be handled better by the private sector. For its part, the Real Property Services Branch of Public Works and Government Services Canada (PWGSC) began a process of self-examination that ultimately led to its "Alternative Forms of Delivery" (AFD) initiative, part of which was contracting out the management of many of its office buildings.

18.10 In its 1995 Business Plan, the Branch identified its principal role as that of "real property advisor" to the government. Its long-term strategy would be to focus on developing its capabilities to fulfil that role, and "to work more closely with the private sector in the delivery of certain operational and transactional services."

18.11 One of the largest property managers in the country. The Real Property Services Branch of Public Works and Government Services Canada is the primary landlord for a significant proportion of the government's real property holdings, the buildings in the Parliamentary Precinct and most of the many office buildings used by government departments and agencies across the country. As the landlord, the Department traditionally has provided a wide variety of real property services to its tenant departments, ranging from cleaning and fit-up to advice on how to make the best use of real property resources. It is also responsible for the ongoing care and maintenance of the assets. In all, the Department provides office space for some 160,000 public servants in about 2,500 facilities across Canada. Its inventory amounts to about 6 million square metres of Crown-owned and leased space — from office buildings,

laboratories and warehouses to the Parliament buildings and other "national treasures". It also administers 3,000 leases representing annual rent of \$550 million. This makes the Department one of the largest property managers in the country.

18.12 Having defined its role during Program Review, the Branch undertook a study to identify its core services and activities — those it needed to retain to realize its vision of becoming the government's strategic real property advisor and to fulfil its mandated role. At the same time, it would identify the services and activities that fulfilled no special public purpose and therefore could be carried out by the private sector.

18.13 This "Core/Non-core" study generally classified as core activities those that dealt with issues of mandate, program management and strategy, quality assurance and risk management. Typically, the operational aspects of service delivery were identified as non-core and became candidates for contracting out.

18.14 As a result of its study, the Department concluded that the property management services it was then providing to the government were non-core activities and that the private sector might be able to deliver them more cost-effectively. The types of service to be contracted out included cleaning, groundskeeping, mechanical maintenance and operation of building systems, and preparation of annual building management plans. The study further concluded that there was no strategic or public purpose reason why the government should continue to deliver these types of services itself.

18.15 From these conclusions flowed the decision to contract out property management services and to negotiate the possibility of transferring to the successful bidders the PWGSC employees then delivering those services.

The Department concluded that the private sector might be able to deliver property management services more cost-effectively.

The Department wanted to focus more on its advisory role and to save 10 percent on its property management costs.

The decision to contract out

18.16 In recent years, several large companies in Canada have contracted out their property management services, as have some Crown corporations such as Canada Post Corporation and the Canadian Broadcasting Corporation. The real property industry is evolving and developing the capacity to meet the needs of such large clients.

18.17 The main objectives for contracting out property management services usually are to save money, concentrate on core activities and get access to first-class property management capabilities. However, contracting out an operation does not mean abandoning responsibility for it. Although the government has contracted for property management services, it retains responsibility for their funding and is accountable for them to building tenants and to Parliament. It is still the government that decides on the quantity and quality of a service to be provided, and it remains accountable for both aspects of that service.

18.18 In its November 1995 Business Plan, the Department stressed its intent to

change the way its services are delivered. It wanted to focus more on its advisory role and to provide a full range of real property services more affordably and efficiently. In particular, it set a target for the AFD initiative to save 10 percent on its property management costs while providing at least the same level of service. The Branch established a number of principles to guide management in implementing the AFD, to ensure that:

- employees would be protected to the greatest extent possible;
- transferred assets would be maintained in good condition; and
- it would remain the landlord of all the assets and continue to exercise all responsibilities inherent in that role.

18.19 Once the Branch had decided to proceed with AFD in the fall of 1996, the timing of the process was driven by the need to complete the transfer of affected employees to the successful bidder before the terms of the government-wide programs for work force adjustment expired in March 1998. Exhibit 18.1 shows key milestones in the contracting-out process. For a transaction of this size and complexity, this meant that a great deal had to be done in a

Exhibit 18.1

Milestones in Contracting Out Property Management

Date	Event
31 Oct. 1996	Treasury Board informed of decision to contract out
21 Feb. 1997	Request for Qualification issued
8 Jul. 1997	Request for Proposal issued
17 Sept. 1997	Proposals due
17 Sept. 1997 to 10 Dec. 1997	Evaluation of proposals
11 Dec. 1997	Treasury Board approval of contracts
12 Dec. 1997	Letters of intent to enter into contracts
13 Dec. 1997 to 17 Mar. 1998	Negotiation of final wording of contracts
18 Mar. 1998	Contracts signed
19 Mar. 1998	Job offers made and lay-off notices given
19 May 1998	Job offer acceptances due
28 May 1998	Affected employees join the contractor
28 May 1998	Handover of operations from PWGSC to contractor

Source: PWGSC

relatively short time frame. Further, ensuring a fair and competitive process meant that the time allowed for certain of these activities, such as preparation and evaluation of tenders, could not be compressed.

Buildings included in the AFD initiative

18.20 Originally, the Department's intent was to include in the initiative all buildings owned by the Crown that are under PWGSC's custodianship, except those with unique and special requirements such as the Parliamentary Precinct, and buildings with security requirements. In some cases, however, client departments requested that the Department continue to deliver property management services directly, because the AFD initiative had no track record. The Department chose to accede to those requests and excluded the buildings from the first round of contracts. It told us that once it gains more experience with the AFD initiative, it will consider expanding it to include more buildings. Premises leased by the Department were also excluded from the initiative, since property services for them are already delivered by their private sector landlords.

18.21 In structuring the contracting process, available options ranged from a separate contract for each building to one very large national contract for all of them. Ultimately the Department settled on a middle course. It broke the eligible properties into contracting packages, or building portfolios, each of which became the subject of a separate contract.

18.22 Of the approximately 487 buildings with about 3.5 million square metres of space that are owned by the Crown and are under PWGSC's custodianship, more than 100 were excluded from the AFD initiative. The remaining 377 buildings were grouped by geographical area into 18 large portfolios. Management considered that large portfolios were necessary both to realize

economies of scale and to reduce as much as possible the costs of the departmental infrastructure and the associated corporate and administrative services.

18.23 Since PWGSC had been involved with the provinces in "efficiency of the federation" initiatives since the early 1990s, it first invited provincial and territorial governments to advise it if they were interested in providing the services. They showed interest in 5 of the 18 portfolios. The remaining 13 portfolios were offered to the private sector in an open, competitive bidding process. In all, they consisted of 300 buildings with about 2.3 million square meters of office space (see Exhibit 18.2). The same contractor was the successful bidder on each of the 13 contracts.

Scope of contracts

18.24 The scope of AFD contracts for each portfolio included property management, project delivery, retail letting and tenant project services. The activities in each service category are shown in Exhibit 18.3.

18.25 The Department's 1998–99 gross expenditures related to federal accommodations amounted to about \$1.33 billion, of which around \$743 million represented rentals and grants to municipalities in lieu of taxes, and \$230 million represented major capital expenditures (over \$200,000). Of the remaining \$357 million budgeted for the management and maintenance of Crown-owned buildings, about \$211 million was budgeted for the 377 buildings included in the AFD initiative.

Focus of the audit

18.26 Our audit covered the 13 contracts the Department signed with a private sector contractor. We did not look at the five portfolios offered to provincial and territorial governments because not all of the arrangements had been finalized at the time of our audit.

Our audit covered the 13 contracts the Department signed with a private sector contractor.

18.27 Our examination of the contracting process sought to determine whether the procedures that were followed were adequate to protect the interests of the government and the taxpayers and, in particular, whether:

- the procurement process was conducted in a manner consistent with the objectives established for the AFD, and with the government’s rules and guidelines on procurement;
- the resulting contract was, in its significant aspects, consistent with the successful proposal;
- the transition to the contract was managed efficiently and in accordance with the contract;

- the Department has established the procedures necessary to manage its relationship with the contractor; and

- the Department has adequately ensured environmental protection and sustainable development in the AFD initiative.

18.28 We did not examine the merits of the original decision to contract out property management services. Additionally, the timing of our audit work was such that an examination of the financial and operational results of the AFD for the initial operational period ending 31 March 1999 was not practical. The field work for this audit was completed 1 April 1999.

Exhibit 18.2

Building Portfolios Offered Under the AFD Initiative

Portfolios offered to provincial and territorial governments	Number of Buildings	Floor Area (square metres)
British Columbia (except Vancouver)	30	206,802
Northwest Territories *	20	13,911
Prince Edward Island *	7	31,046
Saskatchewan	13	30,084
Yukon Territory *	7	15,902
Sub-total	77	297,745
Portfolios offered to the private sector		
Alberta	10	75,237
Manitoba	12	121,188
Ontario (except Toronto)	58	234,191
National Capital Area — #1	13	345,437
National Capital Area — #2	4	469,950
National Capital Area — #3	23	253,425
New Brunswick	32	59,316
Newfoundland	42	65,913
Nova Scotia	28	69,471
Quebec — East	31	118,433
Quebec — West	30	257,680
Toronto	8	170,165
Vancouver	9	58,731
Sub-total	300	2,299,137
Total	377	2,596,882

Source: PWGSC

* An agreement has not yet been reached. The Department continues to maintain these portfolios.

18.29 We did not audit the prime contractor, Brookfield Lepage Johnson Controls Facility Management Services (BLJC), and nothing in this chapter should be construed as a comment about it. We were concerned solely with the actions of the government.

18.30 Further details on our audit objectives, criteria and approach are presented in **About the Audit** at the end of the chapter.

Observations and Recommendations

The Contracting Process

Solicitation, evaluation and award phases were well managed

18.31 Key stakeholders and, in particular, real property companies and industry associations were consulted before and during the process to solicit their views and to keep them up-to-date on the progress of the AFD initiative. The

contracting for the AFD initiative was set up using a two-step tendering process for each portfolio. The first step, in February 1997, involved posting the Request for Qualifications (RFQ) document on the Department's electronic Open Bidding System. The RFQ was intended to provide the industry with notice of the Department's intent, provide potential suppliers with a statement of the qualifications they would need to bid for the contract(s), and permit the Department to gauge the extent of potential competition. Issuing the RFQ also meant that potential suppliers who might not possess all of the desired qualifications had the opportunity to strengthen their organization, or to form partnerships with others and create a capability to fully meet the government's requirements. The RFQ elicited responses from 28 potential suppliers.

18.32 The second step was to issue the Request for Proposals (RFP) in July 1997. It drew at least three bids on each of the 13 portfolios (in all, 62 proposals for the 13 portfolios from 14 different service

Exhibit 18.3

Scope of AFD Contracts for Each Portfolio

Property Management Services	Project Delivery Services	Retail Letting Services (where applicable)	Tenant Delivery Projects
<ul style="list-style-type: none"> • Preparation of building and portfolio plans • Day-to-day operations • Energy management • Cleaning • Maintenance • Landscaping • Environmental protection • Health and safety requirements • Emergency preparedness • Property management administration 	<ul style="list-style-type: none"> • Management and delivery of construction projects (repairs, upgrade, fit-up and space optimization projects up to a value of \$200,000) 	<ul style="list-style-type: none"> • Management and administration of third-party leases 	<ul style="list-style-type: none"> • All projects requested by tenants (funded directly by tenants and not included in the price of the contracts; estimated annual amount: \$10.8 million nationally)

Source: PWGSC

A significant feature of the contracting process was the Department's use of "fairness monitors".

providers) with the exception of the Alberta portfolio, for which two bids were received.

18.33 The Department established a multi-disciplinary team of experts to evaluate the bids. They used a point-rating system that took into account key factors such as the proposed approach to service delivery (with 35 percent of possible points), quality and quantity of job offers to existing departmental employees (35 percent), qualifications (20 percent), and price and fees quoted (10 percent). The relative weight to be given to each area was known to the bidders and was intended to reflect the Department's priorities and objectives in entering into the contracts.

18.34 To discourage unbalanced bids or attempts to "buy" the contract, the Department structured its evaluation methodology to emphasize technical superiority over price. Bids were required to meet a pricing target established by the Department. This target was based on the amount that the Department estimated it would have spent to provide these services itself, less 10 percent. However, bids would gain few points for being lower than the target amount. Consistent with the guiding principles established for the AFD, the weighting of factors strongly encouraged bidders to present attractive offers to the Department's employees.

18.35 On 12 December 1997, following the completion of the evaluation process, the Minister responsible for PWGSC announced that BLJC had been selected as the sole contractor for all the contracts, since it had submitted a superior bid for each of the 13 portfolios.

Fairness monitoring provided assurance

18.36 A significant feature of the contracting process was the Department's use of "fairness monitors". The first independent monitor provided advice and guidance to ensure the integrity of the overall AFD process, and the second

monitor carried out "fairness" reviews at the solicitation, evaluation and award phases of the contract. The Department thereby received a high level of assurance that this large and potentially controversial project was conducted fairly.

18.37 As the scope of the fairness review work overlapped substantially with our audit scope, we sought to determine whether and to what extent we could rely on that work and reduce our own testing. Based on interviews with the two monitors and a review of their work and relevant documentation, we found that we could rely on their opinions of the fairness of the process (see Exhibit 18.4 for their opinions and a brief description of the scope of their work).

18.38 In our view, the independent assurance provided by the "fairness monitoring" process became particularly important when the contracts for all 13 of the portfolios up for bid were awarded to a single bidder. Such a process involves costs and may not be appropriate for all contracts. For very large and possibly controversial contracts, however, it may be worth the cost to be able to provide all parties — management, ministers, Parliament, industry and taxpayers — with timely and independent assurance that the contracting process used was fair and procedurally correct.

Specifics of the contracts

18.39 All 13 contracts contain the same basic standard terms and conditions. The contracts are for a term of two years and 10 months (28 May 1998 to 31 March 2001). The Crown has the option of extending the term by up to four years. Therefore, the contracts could extend up to six years and 10 months before being tendered again.

18.40 The pricing method used is "cost plus fee". This means that PWGSC reimburses the contractor for only those eligible costs it incurs in managing the buildings, plus the related management fee. Eligible costs include, among other

things, disbursements the contractor makes to deliver services, and labour costs for positions up to the level of property manager or equivalent. The management fee is a predetermined percentage of the costs incurred. This percentage, between 5 percent and 6.8 percent, varies in each portfolio and according to the type of cost involved.

18.41 Overall, the Crown’s annual financial obligation under each of the contracts is subject to a predetermined ceiling, established by the contractor’s initial bid. This means that the contractor

must deliver all services described in the statement of work — including property management, project delivery and retail letting services — for an amount equal to or less than the Crown’s annual financial obligation. The sum of that annual financial obligation for the term of the contract (two years and 10 months) constitutes the estimated contract price. Exhibit 18.5 shows the bids submitted by the successful contractor.

18.42 The amount of the Crown’s total annual financial obligation includes an estimated amount between \$8 million and

Exhibit 18.4

Fairness Monitoring – Opinions on the Fairness of the Contracting Process

	Monitor 1	Monitor 2
Scope of inquiry	<ul style="list-style-type: none"> • The development of the Request for Proposal and the Statement of Work and Model contract • The development of the evaluation process and the criteria to be used • The bid evaluation and selection including the identification of issues and the resolution thereof • The monitoring of conference calls during the contract negotiations 	<ul style="list-style-type: none"> • Reviewed the Request for Proposal and the Request for Qualification documents. • Reviewed the evaluation plans and scoring methodologies/plans developed for the evaluation of the RFP and RFQ. • Reviewed the work and approach used by the team members responsible for conducting the evaluation of the RFP and RFQ. • Attended or reviewed tape recordings of all debriefing sessions provided to bidders who submitted information at the RFQ stage of the bid evaluation process. • Participated in the resolution of all significant fairness issues raised during the course of the evaluation of the RFQ and RFP. • Reviewed the evaluation scoring of the successful bidder. • Attended the debriefings of unsuccessful bidders. • Reviewed the contract between PWGSC and the successful bidder.
Conclusion	<p>“In our opinion, the overall AFD process was conducted with integrity, including equity, openness and fairness of the contracting process enabling consistent reasonable and fair treatment of prospective service providers.”</p>	<p>“Nothing has come to our attention that leads us to believe that the bid evaluation/selection activities were not conducted with integrity, openness and fairness. No issues have arisen which would lead us to believe that all prospective services providers were not treated in a consistent, reasonable and fair manner and that the bid evaluation/selection activities undertaken were not in accordance with those described in the RFQ and RFP.”</p>

Source: The fairness monitors’ opinion letters.

An innovative feature of the contract is the effort to refocus contract management on performance rather than process.

\$9 million in management fees for the contractor. It is important to note that these fees do not represent the contractor's profit, but rather are its gross revenue for these contracts. From these fees the contractor in turn must cover its operating costs and the costs of administering the contracts.

Innovative fee structure and performance monitoring

18.43 An innovative feature of the contract is the effort to refocus contract management on performance rather than process. Accordingly, the contract specifies that during the contract year, the contractor will be reimbursed for eligible costs incurred and for 85 percent of the related management fee. The remaining 15 percent is not to be paid until year-end. This year-end payment (a performance fee) depends on the extent to which the contractor has performed at levels agreed upon at the beginning of the year. The contractor can earn an additional 5 percent of the total management fee (a service excellence fee) in each of three service categories if its performance excels in all

of the measured performance areas for that service category.

18.44 To implement this provision, the Department has developed and written into the contract a comprehensive framework of 32 performance indicators against which to monitor and measure BLJC's performance. They are grouped into three categories: asset integrity, financial, and satisfaction (see Exhibit 18.6).

18.45 The use of key performance indicators places emphasis on performance rather than process, by linking fees earned to performance. However, this requires that both parties define and agree in advance on the performance expected.

Human Resource Issues

18.46 Human resource issues lie at the heart of the AFD initiative, for two reasons. First, the Department had established as a guiding principle for the initiative the greatest possible protection of the position of its affected employees. Second, doing so would, in the

Exhibit 18.5

Bids of the Successful Contractor

Building Portfolios	Bids for the Term of 2 Years 10 Months (Estimated Contract Price)	Bids Expressed on a 12-Month Basis (Crown's Maximum Annual Financial Obligation)
1. Vancouver	15,925,132	5,590,389
2. Alberta	12,619,008	4,428,193
3. Manitoba	19,340,741	6,791,080
4. Ontario (except Toronto)	46,832,766	16,445,706
5. Toronto	38,424,816	13,481,227
6. National Capital Region — #1	69,198,842	24,222,089
7. National Capital Region — #2	115,113,950	40,380,167
8. National Capital Region — #3	59,384,652	20,826,462
9. Quebec — West	49,119,319	17,234,117
10. New Brunswick	13,035,578	4,572,604
11. Nova Scotia	13,136,591	4,608,725
12. Newfoundland	11,425,536	4,006,843
13. Quebec — East	22,870,061	8,019,448
Total	486,426,992	170,607,050

Source: PWGSC

Department's view, require that the transaction take place under the provisions of the government's work force adjustment program set up to help employees deal with the changes that Program Review had generated. Key provisions of the program were to expire on 31 March 1998 and so by that date the Department would have to resolve all of the key issues surrounding the

employment status of those affected. This established hard deadlines for certain events that became critical drivers of many decisions the Department made in the transition phase of the contract, discussed later in this chapter.

18.47 In the RFP, the Department included minimum requirements that bidders had to meet in the job offers they

Exhibit 18.6

Performance Indicator Framework to Monitor and Measure Contractor's Performance

Category	Property Management Services	Maximum Possible Score	Project Delivery Services	Maximum Possible Score	Rental Letting Services	Maximum Possible Score
Asset integrity	Critical events	150	Scope	250	N/A	
	Energy consumption	100	Quality	750		
	Integrity assessment	400**				
	Quality control inspections	350				
Subtotal		1000		1000		
Financial	PMS baseline	600	Portfolio project baseline	250	Rental rates	250
	Forecasting of year end actuals	400	Estimates	250	Revenues	250
			Value for Money	250	Account >15 days	250
			Forecasting of year end	250	Occupancy levels	250
Subtotal		1000		1000		1000
Satisfaction	Professionalism	100	Project plan	300	Letting Approach	500
	Progress SDS	100	Project delivery	300	Letting operations	500
	Effective sub-contracting	100	Delivery against plan	400		
	Information and reporting	100				
	Service calls (Maintenance)	200*				
	Security services	200				
	Managing commercial letting	100				
	Commercial letting revenue	100				
	Service calls — Operations	400*				
	Responsiveness	400*				
Tenant surveys	200*					
Subtotal		2000		1000		1000
TOTAL		4000		3000		2000

* Performance indicators were not assessed during 1998–99.

** Baseline assessment done during the year, year-end assessment not done in 1998–99.

Source: PWGSC

The Department had established as a guiding principle for the initiative the greatest possible protection of its affected employees.

The necessary steps were taken to ensure a proper transition from management by the Department to management by the contractor upon the handover.

submitted with their bid proposals. The Department gave the human resources component of the proposals a weighting of 35 percent when it evaluated the submitted bids. It found that BLJC's proposals exceeded its minimum job offer requirements.

18.48 In its proposal, BLJC committed itself to offering jobs to almost all available operational employees, at their current pay and with a minimum three-year employment guarantee or for as long as BLJC keeps the contracts. In early 1997, about 600 departmental employees were involved in managing and operating the buildings in the 13 portfolios offered to the private sector. In the ensuing months, about 100 of those employees found a job either elsewhere in the government or outside the government. As a result, only 500 employees were available in March 1998 when BLJC made its job offers; 465 accepted and joined BLJC on 28 May 1998.

18.49 Employees who joined BLJC received cash payments. We found that the Department's compensation payments to these employees complied with the Treasury Board's work force adjustment programs. We noted that the method it used to determine the final number of persons available for job offers was appropriate, and that BLJC respected the job offer commitments it had made in its proposals.

Transition Period

Tasks still remain to be completed

18.50 Between the contract award in late 1997 and the date when the services were handed over to the contractor (28 May 1998) there was a transition period in which a significant number of tasks had to be completed. As already noted, the tasks that involved the transition of employees were accomplished on time. Further, the necessary steps were taken to ensure a

proper transition from management by PWGSC to management by the contractor upon the handover. By all reports, the handover went smoothly.

18.51 In the transition period, however, the contractor did not deal with several matters related to operational budgets, building condition, and the establishment of baseline measures for the key performance indicators. The contractor was to have addressed these issues before the contract was signed. They were rescheduled to the handover date, 28 May 1998, but at that date most had still not been completed. The Department advised us that there had been agreement between the parties to defer these issues until other priorities were dealt with.

18.52 The building management plans containing budget baselines and projects are a key control for the Department. Once reviewed and approved by the Department, these plans constitute the basis on which the contractor is to manage the buildings for the planning year in question. They define the ceiling on eligible expenditures and the extent and scope of approved minor projects for the structures. They were to have been prepared by the contractor and reviewed and approved before the handover. They were not completed and approved until well into the first year of the contract.

18.53 Before the handover, the contractor was also to have formally inspected all buildings. The inspection results were to have formed a key baseline for agreement between the contractor and the Department on the initial condition of the buildings, as well as the baseline for measuring asset integrity performance in the first year of the contract. The contractor did not do this work, and in summer and fall of 1998 the Department carried out the inspections at its own expense. In these circumstances, it was very important that the Department receive the contractor's formal concurrence in the assessments of building condition. In some of the contracts there is

written evidence of concurrence, but in others the Department does not have such formal assurance from the contractor.

18.54 Establishing key performance indicators required that both parties define performance. This proved to be much more complex than anticipated, and most baselines for assessing performance were finalized only well into the first year. One consequence is that for much of the year, PWGSC had no indicators against which to assess the contractor's performance. Some of the performance indicators will not be used at all this year, since related baselines for measuring performance have not yet been established (see Exhibit 18.6). More than half (on a weighted basis) of the indicators of customer satisfaction with property management services will not be used or usable this year. As noted above, the core measure of asset integrity is also affected. As with the building condition reports, evidence of the contractor's agreement on the basis for measuring performance is inconsistent among the contracts. Some regions had full, written documentation while others were able to assure us only of oral agreements.

18.55 We note that the contracts provide for paying the contractor "performance fees" and "service excellence fees". For the purpose of determining its eligibility for these fees, the contractor's performance is to be measured according to the key performance indicators. Given that some indicators have yet to be established, the contractor could be paid performance fees and possibly excellence fees this year for results that may have been less than were required. Further, this could lead to problems and disputes over payments.

18.56 The delays in completing all of the transition tasks arose partly because priority was given to meeting the human resources deadline; the contractor had to make the job offers to affected employees on or before 31 March 1998. In a project

of this scope and complexity and given the fixed time constraints, we did not expect that everything could have been completed in time. We did expect, however, that the Department would have established a process to ensure the timely and controlled completion of the tasks that remained to be done. The two parties continue to work on these items, but the Department has not formally notified the contractor of the work that is incomplete, nor has it developed and agreed with the contractor on a plan containing target dates and respective accountabilities for resolving these issues.

18.57 **The Department should develop a schedule of outstanding contractual items, and develop an action plan with the contractor showing when each item will be completed and which party will be responsible for completing it.**

Department's response: Public Works and Government Services Canada accepts the recommendation. The Department has been actively working with its service provider to put in place the outstanding deliverables and will develop an action plan with target dates.

Expected Savings

18.58 One of the Department's objectives for the Alternative Forms of Delivery (AFD) initiative was to achieve a 10 percent annual saving on its property management costs. The Department told us that this target was based on the experience of other organizations and on discussions with industry representatives. It believes that the contractor has sufficient opportunity to achieve the savings of 10 percent by minimizing management costs, particularly in the areas of human resources, contracting and finance — in other words, by reducing administrative costs rather than cutting operating and maintenance costs to a point that might affect client satisfaction and compromise the operation and maintenance of buildings.

We did not expect that everything could have been completed in time. We did expect, however, that the Department would have established a process to ensure the timely and controlled completion of the tasks that remained to be done.

We could not determine whether or not the contracts will yield the expected 10 percent savings. We did find that the contracts contain control mechanisms to facilitate savings.

Determining the cost base

18.59 The Department used its projected costs for 1998–99 as a baseline for measuring savings. From this baseline, it deducted its estimated costs of managing the contracts and the estimated 10 percent savings (in total, about \$20 million) and arrived at the target cost for each portfolio. The bidders were required to offer the specified services for an amount no greater than the target cost.

18.60 The challenge was then to make sure that the baselines would reflect the costs actually incurred by the Department. The baselines were calculated in 1997, using estimates based on actual data for 1995–96 and year-end forecasts for 1996–97. Using the actual costs for 1997–98, we made our own calculation of the costs of maintaining the buildings included in the AFD. We could not reconcile our baselines and those of the Department with sufficient precision to conclude whether the baselines were accurate. This is due in part to material errors made by the Department that overstated the baselines used in the Request for Proposals issued for some major portfolios. However, the Department discovered its errors by applying its own control procedures and subsequently negotiated a number of amendments to the contracts. Although this lowered the cost baselines in those cases, they were still higher than they should have been. As a result, the government will spend more money on those portfolios than it might have spent had the original cost baselines been calculated accurately. The Department has informed us that the additional funds have been used to do maintenance and repair work that would otherwise have been deferred to future years.

18.61 A review of actual results for the first year of operation showed that the cost baselines established for property management services were exceeded in some portfolios. The total ceilings on

those portfolios were not exceeded, however, because less money was spent on the project delivery services. Nonetheless, the Department needs to determine why the baselines were exceeded if it is to ensure that cost reductions are not achieved at the expense of repair and/or upgrade projects; this could have an impact on asset integrity in the longer term.

18.62 The inventory of buildings is changing constantly, and amendments are needed to reflect those changes. The contracts did not contain a structured protocol to determine which costs are to be deleted (or added) in the event that a building is removed from (or added to) the portfolio. Amendments are negotiated case by case by the respective contracting authorities.

Obtaining expected quality and quantity of services

18.63 The concept of a saving implies getting the same or better service at lower cost. To ensure that it would get the quality and quantity of services specified in the contracts, the Branch designed a comprehensive performance evaluation system. In the first year of the contracts, however, the Department has not been able to use many of the performance indicators, including some dealing with client satisfaction and asset integrity (see paragraph 18.54). Other than anecdotal information, the Department does not have enough data to measure customer satisfaction. This will affect the quality and completeness of the contractor's performance evaluation by the Department. The Department is currently finalizing those performance indicators and believes that the performance evaluation system will be fully operational for the second year of the contract.

18.64 Given the evidence we had, however, we could not determine whether or not the contracts will yield the expected 10 percent savings while maintaining at least the same level of service. Nor could

we determine at this time whether assets are likely to be maintained in a condition at least as good as when the Department was providing the services.

18.65 We did find that the contracts contain control mechanisms to facilitate savings. The extent to which departmental personnel monitor the contractor's performance will determine whether the initiative is actually yielding savings. The Department will need to scrutinize annual building management plans and operational baselines and to monitor actual performance against them. It will also need to assess the contractor's cost effectiveness in delivering tenant project services. Only by doing so will the Department be able to ensure that it is continuously getting the value it expects for the money it spends. The Department will need to arrive at an adequate balance between ensuring that the contractor is fulfilling the terms of the contracts and ensuring that its own cost of managing the contracts does not offset any savings.

18.66 The contracts incorporate features that should foster co-operation and promote innovative business processes — both of which should lead to lower costs. At any time during the term of the contracts, the contractor may submit proposals under the Management Value Incentive Program. This is a program that provides incentives for the contractor to develop proposals that will produce savings. If PWGSC accepts a proposal, it becomes a project and the contractor and the Crown share any savings that result. If properly used and controlled, this incentive program could lead to lower costs in the future.

Environmental Issues in the Contract

18.67 The extent to which the management of the government's real property assets reflects the Department's sustainable development strategy (SDS) directly affects the environment. The

contracts made appropriate provision for the contractor to support the Department's environmental activities and to take necessary actions to adhere to the SDS. Departmental asset managers will regularly monitor the contractor's performance and will measure it annually. How well BLJC performs on environmental matters directly affects the fees it will receive under the performance plan.

18.68 All of the buildings initially covered by the AFD initiative were subject to environmental reviews by the Department, and many priorities for action were identified. The contractor's initial portfolio management plans that we reviewed did not show a clear link to these assessments. Furthermore, at the end of our field work, BLJC was finalizing detailed Environment Protection and Conservation Plans for all portfolios. These plans are essential both to support the Department's environmental activities and to adhere to the sustainable development strategy. They are also required under the contract.

Conclusion

18.69 Our examination of the contracting process, from the Request for Qualifications and the Request for Proposals to the evaluation of bids and awarding of the contract, led us to conclude that in all material respects it was carried out in accordance with the regulations and rules for government contracting. Further, nothing came to our attention during the course of our audit that would lead us to doubt the conclusions of the fairness monitors that the process was conducted in a fair and transparent manner.

18.70 We examined the solicitation and evaluation process and the terms of the contracts themselves in relation to the objectives established for the contracting out of property management. The design of the process was, except for errors in

Nothing came to our attention that would lead us to doubt the conclusions of the fairness monitors that the process was fair and transparent.

costing, consistent with the objectives and priorities that the Department had established. The contracts as signed on 18 March 1998 reflected, in all significant aspects, the proposals that the winning contractor had submitted on 15 September 1997. The contracts were well designed and the handover to the contractor went smoothly. Employees were treated in accordance with the Treasury Board's work force adjustment programs.

18.71 The monitoring and performance management procedures needed to track whether the contractor is fulfilling all its obligations were not in place on time. As a result, the Department will not be able to base its 1998–99 assessment of the contractor's performance on a complete set of performance indicators.

18.72 It is too early to assess whether savings expected by the Department from this initiative will be achieved. Calculations of cost bases were not verified independently to provide management with additional assurance that they were reliable and accurate. However, mechanisms that are conducive to achieving savings were incorporated in the contracts.

Some lessons learned

18.73 In large and complex transactions of this kind, the use of "fairness" monitors can provide assurance that the process is transparent and fair. Additional assurance on whether financial objectives are

achieved can be obtained by subjecting the calculation of cost bases to independent verification.

18.74 Contracting out transactions of this magnitude is a complex process that takes a lot of time. Realistic timelines need to be set. However, it cannot be expected that everything will be ready on the start date, and management cannot wait for everything to be in place before going ahead. This needs to be recognized up front and contingency plans prepared early in the process to provide a road map for both parties to deal with any uncompleted tasks.

18.75 Having a good system for documenting all decisions and keeping records of all agreements between parties is an important element of a good accountability framework.

18.76 The transfer of service delivery responsibilities to a service provider in the private sector represents a major shift for departmental personnel, who must learn how to oversee the work effectively and efficiently rather than doing the work themselves.

18.77 In the case of the AFD initiative, the Department conducted extensive consultations before entering into the process, established clear goals for the initiative and developed an accountability framework that defined respective roles and responsibilities. This strengthened the arrangement and increased the initiative's chances of success.



About the Audit

Objectives

Our objective was to examine the contracting out of property management services by PWGSC to determine whether procedures that were followed were adequate to protect the interests of the government and the taxpayers. We sought to determine whether the contracting process had been consistent with the objectives of the Alternative Forms of Delivery (AFD) initiative and had been open and transparent. We also wanted to determine that PWGSC had implemented an adequate accountability framework and controls to ensure that the contractor would comply with the terms and conditions of the contract.

Scope

The scope of this examination included the part of the AFD initiative related to the 13 contracts for the property management services that were signed with the same private sector service provider. It did not include similar agreements signed with other governmental jurisdictions. We have not examined the decision to contract out the delivery of property management services. Our audit consisted of interviews with departmental management and other key stakeholders as well as an examination of all contracts and other relevant documentation.

We have not audited the activities of the bidders and consequently are not commenting on them.

Approach

We looked at the contracting process used to transfer the management and operation of federal buildings to the private sector contractor, and at the Department's administration of the contract during the first 10 months following the transfer. This was because the first 10 months represented the contract's first complete cycle. Furthermore, we have found in examining other large contracting projects that many of the patterns leading to the eventual success or failure of a contract are established in its early stages. However, the timing of our audit work was such that an examination of the financial and operational results of the ADF for the initial operational period ending 31 March 1999 was not practical. The field work for this audit was completed 1 April 1999.

Criteria

Contracting-out process and handover. We expected that the contracting-out process would be managed in a manner consistent with the Department's objectives for the AFD, and that a competitive bidding process would be used and conducted with integrity and openness. We expected that due diligence would be demonstrated to ensure a smooth handover and minimize risks.

Financial objectives. We expected that the initiative would be designed and implemented in a way that could ensure the expected cost savings without affecting the quality of property management services provided and the integrity of the assets.

Human resource management issues. We expected a uniform treatment of employees affected by the initiative, in accordance with the Treasury Board's work force adjustment programs.

Monitoring and performance management. We expected that the Department would design and implement monitoring and performance management procedures to track whether the contractor is complying with the terms and conditions of the contract and is continuously delivering the specified services at the quality required and for the cost agreed to.

Environment and Sustainable Development. We expected that the contracts would require compliance by the contractor with the Department's sustainable development strategy and would take into account the latter's responsibilities under the *Canadian Environmental Assessment Act*.

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