

**LEGISLATIVE ASSEMBLY STANDING COMMITTEE: RESPONSE TO
RECOMMENDATIONS OF THE PUBLIC ACCOUNTS COMMITTEE
REPORT NO.16 *BUILDING FOUNDATIONS FOR VALUE***

GOVERNMENT RESPONSE

Recommendation 1 Page 38

The Department of Finance should develop guidelines for the use of market sounding exercises by government agencies for projects over a determined value. These guidelines must include the requirement that agencies conduct a detailed examination of the capabilities of companies taking part to deliver the mix of services being sought in the proposed contract structure.

Government Response

The Government accepts this recommendation.

The Department of Finance, Government Procurement will draft a new appendix to the Procurement Practice Guide: *A Guide to Products and services contracting, for Public Authorities* (the Guide). This appendix will address the issues identified in Recommendations 1 and 2 of the Report.

Recommendation 2 Page 45

The Department of Finance should develop guidelines to assist agencies should there be limited interest from the market in a project, or if bidders withdraw from the competition leaving a limited field. These guidelines would require agencies to review whether:

- *there are any defects in the scoping or management of the project that may explain the low level of market interest and could be remedied in time for a re-run of the competition; and*
- *the bids on the table offer a good competition and are likely to lead to a value for money solution.*

Government Response

The Government accepts this recommendation.

The Department of Finance, Government Procurement will draft a new appendix to the Procurement Practice Guide: *A Guide to Products and services contracting, for Public Authorities* (the Guide). This appendix will address the issues identified in Recommendations 1 and 2 of the Report.

Recommendation 3 Page 94

The Department of Treasury needs to apply a greater level of scrutiny to the work being carried out by commercial advisors on public private partnership (PPP) and PPP-type projects on behalf of State Government agencies.

Government Response

The Government notes this recommendation.

The process was agreed in advance and the level of scrutiny applied was appropriate with the involvement of the Department of Health, the State Solicitors Office, The Department of Finance and the Office of Strategic Projects.

As noted by the Under Treasurer in his correspondence to the Committee dated 16 November 2011:

“Treasury reviewed and validated that the PSC analysis undertaken was consistent with the National and State Guidelines and the risk assessment process undertaken by DOH and the economic benefits associated with the risk categories retained and transferred under the contract.

The analysis undertaken by Treasury is set out in the advice provided to the Economic and Expenditure Reform Committee (EERC). The EERC paper is the key document underpinning the EERC and Cabinet’s decision to award the contract. Treasury did inform the EERC that it is confident that the assumptions and costings in the model are reasonable and that the contract with Serco represents value for money.”

At the time of the deliberations on the Fiona Stanley Hospital Facilities Management Services Contract (FMSC), Treasury already had in place considerable expertise and resources in the PPP and Public Sector Comparator areas. This full expertise was brought to bear in assessing the FMSC to inform advice to Government.

Through early involvement in PPP or PPP-type evaluation processes Treasury will apply detailed scrutiny to the financial and commercial analysis underpinning such projects. The early involvement approach has been adopted for the three non-residential building PPP projects currently being delivered by Government (Queen Elizabeth II Medical Centre Car Park, Midland Health Campus and Eastern Goldfields Regional Prison) where Treasury has had (and continues to have) extensive involvement from the outset of the procurement process through both its Strategic Projects and PPP Support business units.

Recommendation 4 Page 95

The Department of Treasury needs to ensure that the asset beta used for projects with significant information and communications technology (ICT) elements reflect the risk associated with ICT projects when calculating discount rates.

Government Response

The Government accepts this recommendation.

The asset beta was chosen to best align to advice provided by Infrastructure Australia in the National PPP Guidelines and analysis of appropriate Asset Beta for public hospital projects.

Treasury recognises that for some projects it is not possible to find an indicative beta in the National PPP guidelines. This is particularly the case for projects such as the FMSC project at FSH which combine many different types of services.

Treasury will:

- recommend that a bespoke beta is determined for projects that do not suit the classification given in the National PPP Guidelines. This flexibility is allowed for in the National PPP Guidelines and in the Western Australian specific Public Sector Comparator guidance paper; and
- participate in the review of the betas in the National PPP Guidelines being conducted by the National PPP Working Group.

Recommendation 5 Page 106

The Department of Health needs to regularly audit the quality and accuracy of information being recorded by the Helpdesk in order to independently verify that the services are being delivered in accordance with the requirements established in the contract.

Government Response

The Government notes this recommendation.

The Contract states that:

- The Facilities Manager must deliver the Services in a manner that ensures all aspects of the Services are visible to the Principal in a single, fully verifiable system;
- This system must accurately detail the performance of all Services ensuring all inputs are gathered at the point of initiation and delivery, and all Records relied on to demonstrate performance must be fully reconcilable and auditable;
- The Facilities Manager's performance level achieved in respect of each element of the Service (and against each KPI) must be recorded and easily accessible and verifiable by the Principal;
- The Governance framework established by SMHS for oversight of the FMSC allows clear visibility to ensure services delivered meet contractual requirements; and
- The FSH Contract Management Unit will closely monitor the Facilities Manager's performance, and all aspects of the contract and operations can be audited by the Department.

Recommendation 6 Page 116

The Department of Health will need to closely monitor the effectiveness of the performance measurement regime in use at Fiona Stanley Hospital and be prepared to negotiate changes with Serco should it prove not to provide the level of performance assurance required.

Government Response

The Government notes this recommendation.

The Key Performance Indicator regime that the Facilities Management Contract demands is substantially higher than exists in current public hospital services.

The FSH Contract Management Unit is charged with the responsibility of monitoring the performance of the FM against the Contract and KPIs.

Recommendation 7 Page 118

The Department of Health needs to:

- *develop education packages for clinical staff to ensure that they are aware of the performance requirements of Serco under the contract; and*
- *actively engage clinical staff in the monitoring of Serco's performance of its contracted responsibilities.*

Government Response

The Government notes this recommendation.

Education packages are being developed as part of the FSH induction framework and ongoing training program which will be applicable to all new staff.

SMHS personnel with senior authority, both administrative and clinical, will receive training to ensure a thorough knowledge of the FM's contractual responsibility, and the consequences of not meeting obligations.

Recommendation 8 Page 120

The Department of Health should be required to publicly report, on a quarterly basis:

- *The quantum of failure points incurred by Serco;*
- *The specific performance failures that led to Serco incurring those failure points; and*

- *The monthly service abatement amounts.*

Government Response

The Government notes this recommendation.

From inception the FMSC has been developed with a commitment to transparency and accountability. This is evident from the fact that the signed FMSC has been publicly available on the FSH web site.

The Department of Health is committed to appropriate transparency and will report on Contract performance as it deems appropriate and in line with the Government reporting requirements.

PAC REPORT FINDING	DEPARTMENT OF HEALTH COMMENTS ON FINDINGS
<p>Finding 1 Page 10</p> <p>The Department of Health was facing a range of pressures to ensure that no further delays to the opening of Fiona Stanley Hospital were encountered, including:</p> <ul style="list-style-type: none"> • The political imperative to commence operations at the hospital in April 2014; • Significant financial costs of between \$250,000 and \$400,000 per day for each day that the hospital did not open as scheduled; and • Its part in the reorganisation of health services in the Perth metropolitan area to better meet increasing demand. 	<p>The development of Facilities Management Services Contract (FMSC) has not resulted in any delays to planned opening of Fiona Stanley Hospital.</p> <p>The imperative for operational commencement was and still is driven by clinical services planning and the need for more hospital beds in Western Australia.</p> <p>Although time was a factor in the procurement process, the priority was to negotiate a robust, comprehensive, effective and workable contract. The appropriate time and scrutiny was given to contract development and review to ensure that the outcomes met the requirements of the State.</p>
<p>Finding 2 Page 12</p> <p>The Facilities Management Services Contract was signed with Serco approximately nine months later than planned in the project's procurement plan.</p>	<p>The awarding of the Facilities Management Services Contract was a complex process and the time taken ensured that this was undertaken thoroughly.</p>
<p>Finding 3 Page 14</p> <p>The procurement plan developed by the Department of Health and endorsed by State Cabinet in November 2009:</p> <ul style="list-style-type: none"> • Was based on a poorly scoped 'services matrix' rather than the detailed service specifications that would later be taken to the market; and • Contained financial modelling based on a 25-year contract rather than a 20-year contract. 	<p>The Department refutes the statement that the service matrix was poorly scoped. The service matrix included in the Procurement Plan was entirely appropriate for the purpose of the Plan.</p>
<p>Finding 4 Page 15</p> <p>Regardless of time pressures, the Department of Health did not follow proper processes when it appointed its commercial advisor, particularly as the:</p> <ul style="list-style-type: none"> • Appointment took place without the benefit of a competitive selection process; and • Commercial advisor was carrying out work, sometimes for as much as two months, without a contract in place. 	<p>The Department followed proper process in the selection of consultants for advice in relation to the Facilities Management Services Contract. The selection of the commercial advisor reflect their standing as a well credentialed firm with a sound knowledge of Government processes and substantial relevant experience in the development of public sector comparators for public private partnerships.</p> <p>The Department maintains that these continued allegations have had the effect of unfairly tarnishing the reputation of the Department and its contractors.</p>

PAC REPORT FINDING	DEPARTMENT OF HEALTH COMMENTS ON FINDINGS
<p>Finding 5 Page 16</p> <p>The Department of Health did not finalise the public sector comparator before the request for submissions was issued. This is in breach of the Infrastructure Australia Guidelines, which requires the completion of the public sector comparator before the release of the request for submissions.</p>	<p>The public sector comparator (PSC) was required to be finalised prior to the RFS closing. The PSC was completed prior to the receipt of bids on 31 May 2010 and therefore the value-for-money analysis and the integrity of the process was never compromised.</p> <p>The Department was not required to adhere to the Infrastructure Australia Guidelines as they were not entering into a PPP. However, in the interest of good practice the PSC development process contained in the Infrastructure Australia Guidelines was utilised.</p>
<p>Finding 6 Page 17</p> <p>The fact that the Department of Health was operating under significant time constraints, and that it had failed to fully scope the project before going to market would have been obvious to respondents. This exposed a potential weakness in the State's negotiating position.</p>	<p>The Department rejects the Committee's assertion that releasing certain service specifications shortly after releasing the Expression of Interest signified either that the project had not been fully scoped or that it exposed a potential weakness in the State's negotiating position.</p> <p>Service specifications were released to respondents when they were developed to an appropriate quality and standard. This is reflected by the fact that there were no material changes during the detailed negotiating process, therefore demonstrating that the service specifications were robust and appropriate.</p>
<p>Finding 7 Page 19</p> <p>Many of the service specifications initially released to the market when the Department of Health issued its request for submissions had not been developed to reflect the actual scope of the Fiona Stanley Hospital. Instead, they had been taken from other projects and were applied without consideration as to the ability of a facilities manager to deliver the outcomes sought.</p>	<p>This is an incorrect statement. All service specifications reflected the scope of services at Fiona Stanley Hospital. The Committee in its report have oversimplified the development of the service specifications.</p> <p>The Department researched best practice specifications from within Australia and the UK. The specifications were then refined for the WA health environment. Independent advisors with experience in the development of Service Specifications on Australian health projects assisted in the development and review of the service specifications. Contrary to the findings of the Committee, the service specifications released to the market were output based best practice rather than traditional descriptive process specifications.</p> <p>The fact that there were no material changes to the service specifications during negotiation demonstrates that the specifications were entirely appropriate and reflect the requirements for the Hospital.</p>

PAC REPORT FINDING	DEPARTMENT OF HEALTH COMMENTS ON FINDINGS
<p>Finding 8 Page 19</p> <p>The Department of Health's commercial advisor excluded services totalling approximately 28 per cent of the total value of the contract signed with Serco from the public sector comparator it developed in August 2010. It did so on the basis that the scopes of the excluded services were 'relatively unknown'.</p>	<p>Recent feedback from other Australian Jurisdictions on the quality and rigour of the FMSC Service Specifications and KPI regime has been extremely positive. NSW have indicated an intent to utilise similar Service Specifications within some of their Health Projects.</p> <p>The PSC developed in August 2010 reflected as accurately as possible the scope of services under consideration. The ICT and managed equipment service were not included in this PSC. The scope of the ICT service, architecture and solution required by the State was still being finalised. The Asset List for assets required under the MES was finalised post the completion of the August 2010 PSC.</p> <p>It should be noted that the revised PSC was developed in July 2011 to reflect the detail of these previously excluded services.</p>
<p>Finding 9 Page 21</p> <p>The prices offered by Serco for the provision of individual services at Fiona Stanley Hospital changed substantially during the negotiation process. It seems likely on the available evidence that these changes occurred because of any combination of the following reasons:</p> <ul style="list-style-type: none"> • The size of the hospital increased following the inclusion of the Mental Health and State Rehabilitation facilities. • The scope of many of the services in the service specifications, including the more expensive services (i.e. ICT and estates management) was changed during the negotiation process with Serco. • The key performance indicators outlining the standard to which Serco was expected to deliver the services, and establishing the penalties if those standards were missed, were altered. 	<p>On a project of this magnitude and complexity, a change in the prices negotiated would be expected, as would changes in volumes and scope of services.</p> <p>Through the negotiation process, the State ensured the FM would provide services to a standard that would meet a stringent performance management regime and ultimately deliver optimal services to hospital users and the State.</p>
<p>Finding 10 Page 26</p> <p>The Department of Health was vulnerable to the practice of hold-up during contract negotiations with Serco.</p> <ul style="list-style-type: none"> • The Department originally estimated that contract negotiations would take 	<p>It is noted that the PAC report states "Evaluating how successful the Department's strategies were at overcoming the threat of hold-up is a difficult proposition."</p> <p>The Department refutes the claim that it was vulnerable to hold-up during the negotiation phase. The FMSC is a complex arrangement which was developed</p>

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<p>between two and four months. The negotiations ultimately required nine and a half months to complete.</p> <ul style="list-style-type: none"> • Two of the most expensive elements of the contract—the information and communications technology (ICT) service and the managed equipment service (MES)—appear to have only been considered once negotiations were well advanced. • In the case of ICT, the State acknowledges that it signed a high-risk contract with Serco. • In the case of MES, the performance regime was substantially altered from the form that was initially taken to the market. 	<p>through a rigorous process. The timeframe taken to negotiate the intricacies of the contract demonstrates the intent of the State to ensure the best possible outcome.</p> <p>A number of strategies were implemented to ensure the negotiations proceeded effectively and efficiently. The Department's focus was on achieving quality service plans which would ensure certainty of service delivery.</p> <p>The comments relating to ICT and MES services are not correct; these services were considered well in advance of the procurement and were included in the Expression of Interest and Request for Submissions phases. The details were further elaborated upon during the RFS phase.</p> <p>The State acknowledges that all large ICT projects carry significant risk. In that regard the contract with Serco with was no different.</p> <p>The MES performance regime was changed to reflect the technology banding that was included in the Serco tender response.</p>
<p>Finding 11 Page 37</p> <p>The Department of Health's use of a market sounding exercise was consistent with best practice internationally for the procurement of complex and costly projects.</p>	<p>Noted</p>
<p>Finding 12 Page 37</p> <p>The market sounding report concluded that there was a 'high to very high' level of interest for the proposed contract from the providers of facilities management and integrated services.</p>	<p>Noted</p>
<p>Finding 13 Page 38</p> <p>An objective of the market sounding process was to establish the capability of the market to deliver the facilities management strategy being sought by the Department of Health.</p>	<p>Noted</p>
<p>Finding 14 Page 38</p> <p>The procurement plan, which helped inform the October 2009 State Cabinet decision, stated that there was an 'interested and viable market' for the</p>	<p>The intent of the Market Sounding report was to</p> <ul style="list-style-type: none"> • inform the market of the project;

PAC REPORT FINDING	DEPARTMENT OF HEALTH COMMENTS ON FINDINGS
<p>private delivery of the proposed FMSC. However, the market sounding report on which this conclusion was based did not provide any commentary on the capacities of the companies taking part in the market sounding process.</p> <p>Finding 15 Page 39</p> <p>The Department of Health expanded the scope of its proposed facilities management contract to include portering and sterilisation services following the market sounding process.</p>	<ul style="list-style-type: none"> • obtain feedback on the procurement strategy; and • to establish that there was sufficient market depth.
<p>Finding 16 Page 41</p> <p>The Department of Health's evaluation of the expression of interest was well documented as was the evidence underpinning the evaluation panel's decisions.</p>	<p>Noted</p>
<p>Finding 17 Page 42</p> <p>The Department of Health evaluated Serco's expression of interest as being between 23 and 26 per cent better, on a weighted percentage score, than its two closest competitors.</p>	<p>Noted</p>
<p>Finding 18 Page 42</p> <p>The Department of Health consistently expressed confidence in Serco's response to the selection criteria used for assessing the expressions of interest; however, the Department documented a number of reservations against these same criteria for the other two companies recommended for inclusion in the request for submissions process.</p>	<p>Noted</p>
<p>Finding 19 Page 43</p> <p>One of the three short-listed respondents withdrew from the selection process because it appears to have concluded that it could not provide a solution that would deliver what the Department of Health was seeking.</p>	<p>Noted</p>

<p>Finding 20 Page 45</p> <p>The Department of Health did not appear to consider whether defects in the scoping or management of its proposed Facilities Management Services Contract led to the early withdrawal from the selection process of the third short-listed respondent, raising serious concerns regarding the level of competition in the whole process.</p>	<p>The Department rejects the assertion that there were defects in the scoping of the FMSC. The company concerned clearly made a commercial decision to withdraw from the process.</p> <p>During the Market Sounding and Expression of Interest process it was clearly demonstrated that there was substantial market interest.</p> <p>One of the reasons of short-listing three respondents was to maintain competitive tension in case one respondent withdrew.</p> <p>The Facilities Management Working Group assessed the situation at the time and determined that sufficient competition remained. This working group comprised of representatives from Department of Health, the then Department of Treasury and Finance, and the State Solicitor's Office.</p>
<p>Finding 21 Page 46</p> <p>The Department of Health's evaluation of the request for submissions was well-documented, as was the evidence underpinning the evaluation panel's decisions.</p>	<p>Noted.</p>
<p>Finding 22 Page 47</p> <p>At the conclusion of the request for submissions stage, Serco had maintained its very large lead in the evaluation scores from the expressions of interest stage, indicating that there was only ever one likely supplier taking part in the tender process.</p>	<p>This is a subjective statement by the Committee. Throughout the process from the Market Sounding through to signing of the contract, the Department maintained the opinion that there was a competitive and interested market.</p>
<p>Finding 23 Page 48</p> <p>The Department of Health, whilst seeking to benefit from the bundling of many services into a single contract, failed to achieve a genuinely competitive procurement process.</p>	<p>The Department refutes that there was not a genuinely competitive process.</p> <p>There were a number of core services where bids were comparable and clearly demonstrated competitive tension. At the conclusion of the RFS stage, there remained two bidders, both of which elected to bid for the full breadth of services, which provides evidence that bundling of services was not a barrier to a competitive environment. The favourable outcome of the tender process when compared to the PSC is further indicative of the fact that a competitive process was followed.</p>

<p>Finding 24 Page 52</p> <p>By using the <i>Project Management Services Panel</i> rather than the <i>Audit Services and Financial Advice Panel</i> to select its commercial advisor, the Department of Health was unable to consider any of the leading firms that provide commercial advice on major projects</p>	<p>The Department's selection of its commercial advisor reflected their standing as a well credentialed firm with a sound knowledge of Government processes and substantial relevant experience in the development of public sector comparators for public private partnerships and the outsourcing of government services (not limited to WA Government). The Department maintains that its use of the <i>Project Management Service Panel</i> did not detract from the quality of commercial advice provided to the Department.</p> <p>The Department engaged other leading firms to provide specific advice on other aspects of the project as required.</p>
<p>Finding 25 Page 53</p> <p>The available evidence suggests that the Department of Health engaged in contract splitting when appointing its commercial advisor:</p> <ul style="list-style-type: none"> • The contracts are for similar services or different components of the same service; • Three contracts were signed on the same day, each for \$136,400; • The contracts are with one supplier, the Paxon Consulting Group; and • The estimated values for almost all of the contracts fall just below the threshold requiring competitive tendering processes. 	<p>The Department firmly and categorically rejects the continued assertion of the Committee that the Department engaged in contract splitting.</p> <p>Despite the provision of lengthy advice and substantiation by the Department on several occasions, the Committee has failed to recognise that the 3 contracts in question were 3 distinct and separate pieces of work, of which only one related to the Facilities Management Services Contract.</p>
<p>Finding 26 Page 55</p> <p>The Department of Health split the contract for the provision of commercial advice into a series of smaller contracts over the life of the procurement of the Facilities Management Services Contract. This allowed the Department to directly appoint its preferred commercial advisor without a competitive selection process.</p>	<p>The Department rejects the assertion that the contract for the provision of commercial advice was split in order to appoint its preferred commercial advisor without a competitive selection process. The Department maintains that in this instance it was appropriate to contract in components with each contract providing for a distinct and separate piece of work as it was not always known or certain that the next stage would proceed.</p> <p>At all times the Department followed proper process in the selection of consultants for advice in relation to the Facilities Management Services Contract. Each engagement was in accordance with the buying rules that applied at the time.</p> <p>The selection of the commercial advisor reflected their standing as a well credentialed firm with a sound knowledge of Government processes and substantial</p>

	<p>relevant experience in the development of public sector comparators for public private partnerships.</p>
<p>Finding 27 Page 55</p> <p>Given that Cabinet had decided to procure such a large and complex range of services through the Facilities Management Services Contract, the Department of Health should not have used a series of rolling contracts to employ Paxon to provide commercial advice. Rather, it should have tendered for a single engagement covering the life of the procurement process.</p>	<p>It was appropriate to contract in components with each contract providing for a distinct and separate piece of work as it was not always known or certain that the next stage would proceed.</p>
<p>Finding 28 Page 57</p> <p>The Department of Health claimed to have only considered price rather than skills, experience or ability, when selecting firms to make submissions for the only piece of commercial advice work awarded through a competitive selection process.</p>	<p>This is incorrect. Price was not the only consideration. The firms invited to tender were pre-qualified and deemed appropriate to be on the Commercial Advisory Panel. The firms selected to quote had the experience and skills necessary to undertake the requirements.</p>
<p>Finding 29 Page 57</p> <p>In its explanations to us, the Department of Health consistently failed to demonstrate that it understood that not all firms on panels are equal and that they have varying levels of skills and abilities.</p>	<p>The Department recognised the varying level of capabilities, however is conscious of achieving value for money when engaging expert advice.</p> <p>The Department maintains it followed the proper process in the selection of consultants. In the particular instance the Committee is referring to here, the Department considered that inviting five companies more than met the 'sufficient quotes' requirement. The Department believes that it obtained a value for money outcome through the process.</p> <p>The Committee ignored the information provided by the Under Treasurer, justifying Paxon's selection on the panel and verifying its capability to provide PPP advice on the basis that:</p> <ul style="list-style-type: none"> • <i>"The Respondent (Paxon) demonstrated excellent organisational capacity</i> • <i>The personnel (Paxons) have the skills and expertise to provide these services to a high standard.</i> • <i>They have demonstrated extensive experience in high value PPP infrastructure contracts for government and private organisations."</i> <p>The Committee has failed to acknowledge that Paxon Directors are well credentialed, experienced and held in high regard within the health sector.</p>

<p>Finding 30 Page 58</p> <p>The Department of Health awarded Paxon the work of providing critical advice for the State's largest ever services contract without any real element of competition in the selection process.</p>	<p>The Department refutes this finding. The Department followed proper process in the selection of consultants for advice in relation to the Facilities Management Services Contract. In this respect the selection of the commercial advisor reflects their standing as a well credentialed firm with a sound knowledge of Government processes and substantial relevant experience in the development of public sector comparators for public private partnerships.</p> <p>Moreover, contributions from the Department of Health and the Department of Treasury were also critical to Government decision making.</p>
<p>Finding 31 Page 61</p> <p>The Department of Health combined the provision of commercial and technical advice from one advisor, an unusual approach when compared to the management of advice on other PPP-type contracts in Western Australia.</p>	<p>The FSH Facilities Management Services Contract is not classed as a PPP project. A PPP is a contract between public and private sectors for the delivery of public infrastructure and related ancillary services, and the FSH contract does not fall within this scope.</p> <p>The commercial advisor was not the sole provider of advice to the Department. A number of other technical advisors were utilised for advice on engineering, ICT and other areas requiring specific expertise including experts within Treasury and Health Finance.</p> <p>The Committee have focused their attention on one advisor rather than recognising that the Department engaged various leading experts and firms throughout the process when specific advice was required. These include:</p> <ul style="list-style-type: none"> • KPMG for expert accounting advice. • E&Y for review of non-clinical specifications for FSH. • Applan Group for review of Hard FM service specifications. • MbMpl for review of FM service specifications and assessment of RFS responses. • SG2 to develop and review major medical equipment specifications for MIES. • Ferrer Hodgson for expert financial assessment of respondents. • IT Newcom for benchmarking review of ICT service. • Healthkare Intelligence for FF&E advice.

	<ul style="list-style-type: none"> • Broadreach for review and development of ICT requirements. • Stantonons for Probity advice.
<p>Finding 32 Page 63</p> <p>Poor coordination between the Department of Health (DoH), the Office of Strategic Projects and Building Management and Works resulted in delays to the formal signing of contracts for the provision of commercial advice for the Facilities Management Services Contract. However, it was DoH's responsibility to have those contracts in place in time.</p>	<p>Noted.</p>
<p>Finding 33 Page 63</p> <p>On several occasions the Department of Health's commercial advisor was completing work before contracts were in place exposing the State to risks that the contract would have minimised, including the risk of substandard work and cost escalations.</p>	<p>The commercial advisor undertook to begin this work at their own risk. The commercial advisor was aware that they were not engaged up to that point, but in goodwill started providing the services (with no guarantee of being paid until a contract was awarded) to ensure that the project was able to stay on program.</p>
<p>Finding 34 Page 63</p> <p>As a result of delays from the Department of Health in making Building Management and Works (BMWV) aware of the need for contracts for commercial advice, BMWV was not able to play an oversight role in the Department of Health's use of panel contracts.</p>	<p>Noted. The Department notes that BMWV provided evidence to the Committee on its role on this matter.</p>
<p>Finding 35 Page 65</p> <p>On the evidence provided to the Committee, and the responses provided by the Department of Health (DoH) when pressed on these matters, DoH went to some lengths to ensure that competitive processes for the selection of its commercial advisor did not occur.</p>	<p>The Department strongly refutes this finding.</p> <p>The Committee has made a subjective assessment that has not been substantiated. As has been explained to the Committee on several occasions the panel from which the commercial advisor was selected, was a pre-qualified panel that was established by competitive processes to begin with and in accordance with the buying rules that applied at the time.</p>
<p>Finding 36 Page 68</p> <p>The Department of Health sought to develop the public sector comparator for the Facilities Management Services Contract in compliance with the requirements of Infrastructure Australia's public private partnership Guidelines</p>	<p>Noted.</p>

<p>Finding 37 Page 73</p> <p>The Department of Health did not appear to have a solid understanding of the work being completed by its commercial advisor. The Auditor General arrived at similar conclusions about the quality of the Department's supervision of advisors in an earlier report regarding the construction of Fiona Stanley Hospital.</p>	<p>The Department refutes this finding. The Department's expertise is best applied towards assessing the commercial analysis and advice provided by its contractors to inform advice to Government. For complex commercial contracts of this nature it is appropriate that the Department engages consultants to conduct the detailed technical work and provide expert commercial advice given that the Department is not resourced to undertake the detailed work and technical expertise may not be readily available within the Department.</p>
<p>Finding 38 Page 76</p> <p>At least four different public sector comparators were developed for the Department of Health by its commercial advisor during the procurement of the Facilities Management Services Contract.</p>	<p>It is a normal and expected process to have a PSC that is refined as projects develop.</p>
<p>Finding 39 Page 77</p> <p>Each of the four different public sector comparators (PSCs) examined during this Inquiry were developed using widely varying assumptions:</p> <ul style="list-style-type: none"> • The first PSC, developed in September 2009, assumed a contract length of 25 years and was based a poorly scoped 'services matrix' rather than the detailed service specifications that would later be taken to the market. • The second PSC, developed in May 2010, assumed a contract length of 10 years and excluded two of the three most expensive elements of the contract from its calculations—the managed equipment service and the information and communications technology service. • The third PSC, developed in August 2010, reflected the correct contract length of 20 years, but excluded services totalling approximately 28 per cent of the total value of the contract signed with Serco on the basis that scopes for these services were 'relatively unknown' or because not all bidders included the services in their bids. • The fourth PSC, developed in July 2011, reflected the contract as signed with Serco. Given that this was the first PSC to be developed using the full scope of the contract, this was probably the first opportunity for DoH to gain an accurate understanding of potential value for money achievable through engaging with the private sector. 	<p>The Committee quotes in its report: "<i>Developing a number of PSCs is not atypical, as the results contained in the PSC will be refined as the scope of the project becomes clearer or, once the contract with the preferred bidder has been negotiated, to reflect the changes to the specifications signed in the final contract</i>"</p> <p>Consistent with the Committee's observation, it is a normal and expected process to have a PSC that is refined as projects develop.</p>

<p>Finding 40 Page 78</p> <p>The accuracy of the raw costs included in all but the final public sector comparator appears to have been undermined by the use of poorly scoped service specifications.</p>	<p>This is incorrect. Service specifications were completed to an appropriate quality and standard. The raw costs applied in each set of analysis accurately reflected the specifications at that time.</p>
<p>Finding 41 Page 84</p> <p>The Department of Health acknowledges that the information and communication technology components of the Facilities Management Services Contract are high-cost and high-risk.</p>	<p>The ICT solution in any large health organisation is complex. Whilst there is scope for some price variation, this is dealt with in the ICT contingency.</p> <p>The cost and risk associated with the ICT solution was independently evaluated and deemed to be consistent with the ICT in other large health projects.</p>
<p>Finding 42 Page 84</p> <p>The information and communication technology (ICT) service contingency payment has been designed to cap the financial impact of risks arising from the ICT components of the Facilities Management Services Contract, whilst retaining the possibility of variation due to unforeseen events.</p>	<p>Noted.</p>
<p>Finding 43 Page 86</p> <p>The State's exposure to the risk of cost escalation in the delivery of the information and communication technology (ICT) components of the project may not be capped, as the Department of Health states, if Serco requires variations to the contract in order to deliver the services identified on the ICT compliance document.</p>	<p>Despite a number of clarifications, the Committee has misunderstood the purpose and application of the ICT services contingency.</p> <p>The ICT compliance summary is made up of a number of different sections (for example: further design required, aspirational requirements etc) some of these items would fall under an ICT contingency event and others may constitute a Variation.</p> <p>Each would need to be addressed on a case by case basis at the time. Payment might be drawn from the ICT contingency pool or be subject to a Variation requiring Principal approval. They are mutually exclusive alternatives.</p> <p>It is envisaged that many of the compliance issues may be resolved with no requirement for additional funding. There will be some that will require further work and may trigger an ICT contingency event. For some other "unknowns" they may be subject to Variation rather than an ICT contingency event. Where there is a 'material' change to the ICT Solution i.e. the Principal elects to change the output requirements this would constitute a Variation and would be done in accordance</p>

	<p>with section 26 of the FM Contract.</p> <p>Note also that the order of precedence within the contract is that the ICT contingency payment ranks before any potential variation.</p>
<p>Finding 44 Page 89</p> <p>The only competitive neutrality calculation applied to the public sector comparator for the Facilities Management Services Contract related to the exemption from the payment of payroll taxes by State Government bodies.</p>	<p>Noted</p>
<p>Finding 45 Page 93</p> <p>Two different measures of systematic risk were applied to the public sector comparators (PSCs) completed in August 2010 and July 2011.</p> <ul style="list-style-type: none"> • The information and communications technology (ICT) components of the project were excluded from the August 2010 PSC; however, they were included in the PSC developed in July 2011. ICT is generally considered to be a high-risk infrastructure type reflected in the risk-banding assigned by Infrastructure Australia (IA). • ICT represents a significant proportion of the total cost of the Facilities Management Services Contract. • The measure of systematic risk applied to the August 2010 PSC was greater than that assigned to the July 2011 PSC despite the exclusion of high-risk ICT from the earlier version. • This is a counter-intuitive shift in measurement that is not supported by the evidence or the guidance contained in the IA Guidelines. 	<p>The asset beta was chosen to best align to advice provided by Infrastructure Australia in the National PPP Guidelines and analysis of appropriate Asset Beta for public hospital projects.</p>
<p>Finding 46 Page 94</p> <p>It seems likely that the Department of Health did not have sufficient understanding of the work of its commercial advisor to adequately scrutinise important assumptions that were being applied in the public sector comparator.</p>	<p>This finding is refuted by the Department. As outlined in the Departments' comments to Finding 37, the Departments' expertise was appropriately applied towards assessing the commercial analysis and advice provided by its commercial advisor and in formulating its advice to Government on the FM contract.</p>
<p>Finding 47 Page 95</p> <p>Despite representing a significant proportion of the total cost of the Facilities Management Services Contract, and belonging to the higher risk band, the</p>	<p>The discount rate and its component asset beta were chosen to best align to advice provided by Infrastructure Australia in the National PPP Guidelines and analysis of</p>

<p>ICT components were not taken into account when calculating the discount rate used to analyse bids.</p>	<p>appropriate for public hospital projects.</p>
<p>Finding 48 Page 96</p> <p>The Department of Health's commercial advisor did not follow the Infrastructure Australia Guidelines when it used the 10-year Commonwealth Government bond rate, rather than the equivalent Western Australian bond rate, to determine the risk-free rate used during the calculation of the discount rate for the project.</p>	<p>The risk free rate applied was reviewed by the Department of Treasury as being the appropriate rate.</p>
<p>Finding 49 Page 104</p> <p>Important details about how Serco would deliver the services at Fiona Stanley Hospital were not finalised at the time that the contract was signed with Serco. These details will continue to be refined in the lead-up to the commencement of operations at the hospital in April 2014.</p>	<p>The Service Specifications are the State's requirements for the delivery of the services and these are fully set and not subject to change.</p>
<p>Finding 50 Page 105</p> <p>Many of the key performance indicators against which Serco's performance in delivering the services will be measured require Serco to perform tasks in accordance with detail contained in the service plans.</p>	<p>The Service Specifications are the State's requirements and these are fully set and not subject to change.</p> <p>The Facilities Managers services must meet the KPIs irrespective of the state of development of those plans.</p>
<p>Finding 51 Page 105</p> <p>Many of the service plans, including the cleaning service plan, have not been completed to the level of detail where Serco has outlined how it will deliver the services. This means that the key performance indicators are making specific reference to Serco's obligations in the service plans before those obligations have been agreed to in detail.</p>	<p>This finding represents a misunderstanding of the contract by the Committee. The Key Performance Indicators measure performance of the services against the Service Specifications.</p> <p>The Service Specifications are the State's requirements and these are fully set and not subject to change.</p> <p>The Facilities Managers services must meet the KPIs irrespective of the state of development of those plans.</p>

<p>Finding 52 Page 106</p> <p>Information about the performance of Serco in delivering the services at Fiona Stanley Hospital will be recorded through the centralised Helpdesk, which is a service also provided by Serco.</p>	<p>Noted.</p> <p>The Contract clearly states that:</p> <ul style="list-style-type: none"> • The Facilities Manager must deliver the Services in a manner that ensures all aspects of the Services are visible to the Principal in a single, fully verifiable system. • This system must accurately detail the performance of all Services ensuring all inputs are gathered at the point of initiation and delivery, and all Records relied on to demonstrate performance must be fully reconcilable and auditable. • The Facilities Manager's performance level achieved in respect of each element of the Service (and against each KPI) must be recorded and easily accessible and verifiable by the Principal.
<p>Finding 53 Page 109</p> <p>If Serco's performance across the range of services is sufficiently below standard in any given month, it is possible that 100 per cent of its monthly payments could be abated as a result of the performance failures.</p>	<p>Noted.</p>
<p>Finding 54 Page 110</p> <p>The contract with Serco can be terminated by the State if, during any rolling three month period, the number of failure points accumulated for all services exceeds an amount established in the contract.</p>	<p>Noted.</p>
<p>Finding 55 Page 112</p> <p>There is a general preference for bank guarantees to be used rather than insurance bonds for the purposes of performance security on infrastructure projects. Despite this, the significant majority of the performance security offered by Serco is in the form of insurance bonds.</p>	<p>The utilisation of insurance bonds is acceptable practice.</p> <p>The form of the insurance bonds provided was assessed by the State's advisers as providing a similar level of surety as to a bank guarantee with counter parties of a similar credit rating.</p>

Finding 56 Page 121

- The delivery of non-clinical services at Fiona Stanley Hospital will in all matters need to conform to the signed contract between Serco and the Department of Health.
- All such contracts are incomplete inasmuch as they are incapable of covering every eventuality that may arise in a contract which is likely to last 20 years.
- The success of this contract with Serco will rest on both the details of the contract and the quality of the working relationship between the contract partners.

Noted