

Procurement Guideline 2011



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Matters to be considered

Practical considerations

The Office of the Auditor-General (OAG) offers advice when deciding how to give effect to the principles set out in the manual. The OAG suggests that councils should consider a range of matters:

- **The goal:** It is important for the Council to focus on what it is trying to achieve. The process should not dominate at the expense of the outcome.
- **Simplicity and proportionality:** The requirements put in place for the funding arrangement should be as simple and practical as possible, considering the amounts involved, the complexity and the level of risk. It is appropriate to consider compliance costs for both parties, and seek to reduce them where possible.
- **The context:** The arrangements need to fit with the overall context of the funding arrangement, including any more general relationship that the external party has with Council or with other relevant government organisations. For example, a funding arrangement between Council and a non-government organisation may need to take account of any general government policy on relationships with the community and voluntary sector.
- **The risk:** Council needs to identify risks in or around the funding arrangement and to consider how to manage those risks. This should not be seen as encouragement to be overly risk averse. The key is to get the right balance between risk and expected benefit and to do so consciously.
- **The nature of the parties:** The needs and standards of Council, for example, for accountability or transparency, may be quite different from those that the external party usually encounters. Equally, the external party's needs may be quite different from those of Council. For example, a non government organisation may have unique obligations to constituent groups or members. Relationships are likely to proceed more constructively and effectively if each party understands the needs of the other and the consequence of those needs for them.

Financial delegations

Financial delegations of Council are detailed in the Gisborne District Council's **Delegation Manual** (EDRMS No. 177370). No person shall enter into a contract or funding arrangement (including purchasing of goods and services) on behalf of Council unless they have specific delegation to do so or by formal resolution of Council.

Council requires that all procurement of works, goods or services valued over \$50,000 (plus GST) will be subjected to a competitive procurement process and the type of process (for example, seeking quotations or using a tender or proposal process), will take into account the level of risk and the type of works, goods or services to be procured.

(Also refer to "**Selection of Procurement Methods for Works, Goods and Services**", later in the Guideline for further clarification.)

Overriding consideration

There are four main different types of purchasing/funding:

- **Minor conventional purchases:** These are works, goods or services that Council buys regularly, are of relatively low value, and are able to be bought through ordinary procurement systems. There will usually be a reasonable range of suppliers or providers to choose from so that ordinary market disciplines and competitive processes are likely to be effective as a way of managing the price and value for money.
- **Major conventional purchases:** As with the previous category, the presence of an effectively functioning market is the main factor in a major conventional contracting environment. That means that ordinary market-based procurement techniques can be expected to operate well to manage the price and value for money. Major conventional purchases are high value - possibly worth millions of dollars. Inevitably they carry higher risk to the organisation and require a different level of planning, authorisation, documentation, monitoring and general management.
- **Minor relational purchases:** For the contracts in this category, conventional market-based systems may not be appropriate or particularly effective. This is largely due to the absence of an effective or meaningful market to provide the goods or services, and the strategic importance of the goods or services, or the relationship with the provider, for Council. In these situations, it may be more useful to give greater weight to the relationship or strategic dimensions of the contract (or funding arrangement) and to develop other systems to manage the dimensions usually managed by competitive market mechanisms.
- **Major relational purchases:** The same factors identified under minor relational purchases apply here. The main difference between the previous category and this one is the value or size of the works, goods or services being purchased or funded. A larger contract will inevitably require additional attention and management throughout its whole lifecycle. There is an overlay between this category and that of major conventional purchases, through the growing use of relationship-based contracting arrangements in major projects such as infrastructure development (eg alliancing or partnering arrangements).

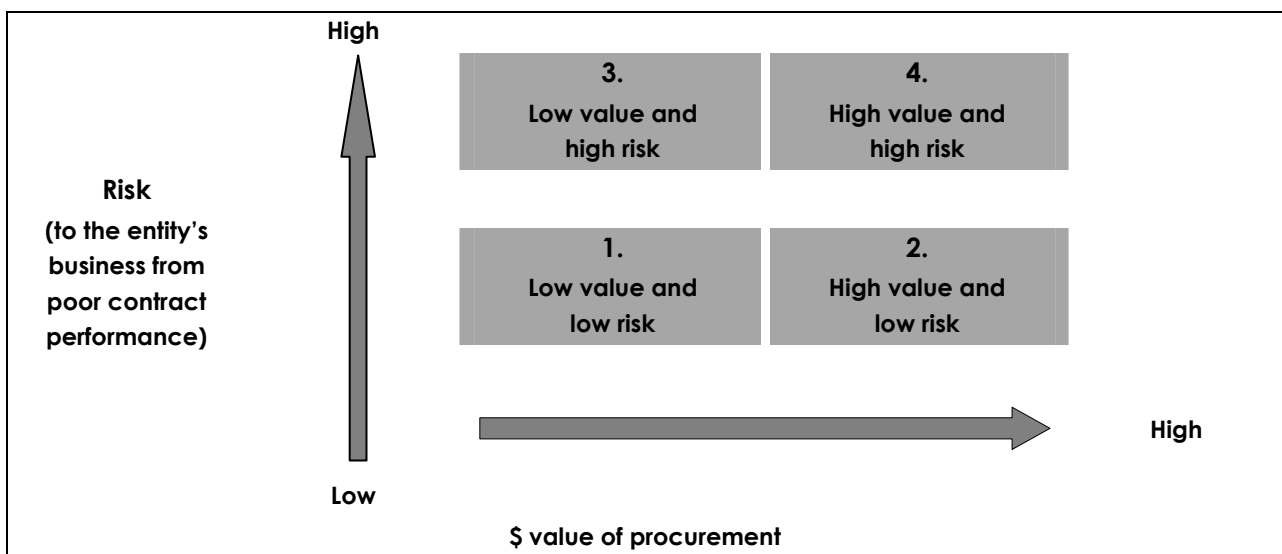
Value for money considerations

Value for money means using resources effectively, economically and without waste with due regard for the total costs and benefits of an arrangement and its contribution to the outcomes Council is trying to achieve. In addition, the principle of value for money when procuring goods or services does not necessarily mean selecting the lowest price but rather the best possible outcome for the total cost of ownership (or whole-of-life cost). Value for money is achieved by selecting the most appropriate procurement method for the risk and value of the procurement and not necessarily by using a competitive tender.

Risk considerations

Figure 1 shows how the risk and value of the procurement provides a useful categorisation of works, goods and services as a means of identifying and developing different strategic responses for each category. This approach can help Council to choose an appropriate procurement strategy to address the risk and value of the works, goods or services being procured. Council may also find it useful to establish what proportion of its total expenditure on procured items is in each quadrant. Typically, quadrant 4, high risk and high value items, can make up more than half the value of the Council's total expenditure on procured works, goods and services.

Figure 1: Analysing type of procurement to identify procurement method



Sustainability

It is becoming increasingly important for councils to work and think in ways that take account of long term sustainability. Sustainability involves thinking broadly about objectives, considering long term as well as short term effects; assessing indirect as well as direct effects; considering economic, social, cultural and environmental aspects; and taking extra care when procurement causes changes that might be irreversible or uncertain (the precautionary principle).

Sustainability is a statutory or strategic requirement for councils. For example, the Local Government Act 2002 requires local authorities to take a sustainable development approach, by taking into account the social, economic, environmental, and cultural wellbeing of people and communities, the need to maintain and enhance the quality of the environment, and the needs of future generations.

Given the growing strategic importance of sustainability in councils, considerations of sustainability may occur throughout the entire procurement process. Examples of the types of activities that might be carried out, as part of procurement, to assist sustainability include:

- specifying products and services considered to be sustainable
- verifying suppliers' sustainable management standards
- including a sustainability clause in contracts

- rating supplier performance against sustainability criteria
- insisting on sustainability improvement targets for suppliers
- assisting suppliers to improve their sustainability performance, and
- encouraging sustainable innovation in the supply of goods or services.

Legal considerations

Council must be aware of, and comply with, all applicable legislation (and amendments) when it funds or procures works, goods or services. Examples of applicable legislation are:

- the Local Government Act 2002
- the Official Information Act 1982
- the Local Government Official Information and Meetings Act 1987
- the Commerce Act 1986
- the Fair Trading Act 1986
- the Public Records Act 2005
- the Local Authorities (Members' Interests) Act 1968
- the Electronic Transactions Act 2002, and
- the Land Transport Management Act 2003.

Some of Council's governing legislation will include requirements to consult on significant issues, for example, with the community or with stakeholders. Examples include the Local Government Act 2002, the New Zealand Public Health and Disability Act 2000 and the Land Transport Management Act 2003.

A procurement process may result in significant changes to the content or form of the services that Council delivers or a change of approach to the way it funds some services. If Council has statutory consultation obligations, it will need to consider the relationship between the procurement process and these obligations.

Council has public law obligations that could apply to aspects of a procurement process. Council's fundamental public law obligation is always to act fairly and reasonably, and in keeping within the law. This imposes a higher standard of conduct than that which may apply in the private sector. Council should always take account of the risk that its funding and procurement actions and decisions could be subject to judicial review, or a complaint to an Ombudsman, or to the Auditor-General.

The extent to which Council's procurement actions or decisions are subject to judicial review depends on several factors including the nature and the decision-making framework it operates under. The courts have shown a willingness to intervene in commercial relationships in a wide range of situations to ensure that a Council acts fairly and in keeping with its public law obligations.

Contractual considerations

Council should be aware of, and must comply with, the relevant law on the formation and performance of contracts. Particular legal risks may exist when procuring with a competitive tender or proposal process. At times, it may be appropriate for Council to create a contractual situation during the procurement process itself (a "process" contract). However, Council needs to be careful that it deliberately and not inadvertently creates any legal obligations.

In general, an invitation to submit a tender or proposal, or a request for tender or proposal, is an "invitation" not an "offer" to purchase goods or services. However, a preliminary contract may sometimes exist for the tender or proposal process itself.

For example, if Council specifically defines the process in the procurement documentation that it issues to participants, that definition could be construed as an offer to proceed in that manner, which a participant accepts by submitting to the procurement process. That may be enough to create a binding contract for the process. If a process contract is created it will contain express and implied terms. The express terms will be those in the procurement documentation and the implied terms will include a requirement to treat all participants fairly and equally.

If Council then follows a different process, it may risk legal action for breach of contract. Council may seek to minimise this risk by excluding or limiting its liability in the procurement documentation for any breach by Council during the procurement process. Where participants participate on that basis, a court may be likely to recognise such an exclusion or limitation provision as being contractually effective.

Liability

When contracting for goods or services a supplier or purchaser may wish to exclude or limit its liability under the contract. It is not uncommon for suppliers to:

- propose excluding their liability for any losses that are not the direct result of their acts or omissions (for example, for indirect loss, consequential loss, loss of profits); and/or
- limit their liability to an amount that is a specified multiple of the value of the contract.

Accepting a limitation on liability is different from giving a supplier an indemnity. In accepting a limitation on liability, Council agrees to limit the liability of a supplier to an amount specified in the contract. If the Council suffers loss through the supplier's actions or omissions in performing the contract, Council will not seek to recover more than the agreed amount and will bear any loss above that amount.

An indemnity, however, involves Council agreeing to accept the risk of loss or damage that the supplier may suffer, and to meet any costs to the supplier for that loss or damage. Councils need to be aware of statutory restrictions on giving indemnities, for example, in the Public Finance Act 1989 and the Crown Entities Act 2004.

Limiting a supplier's liability in a contract has the effect of exposing Council to liability above the limit in the contract which is therefore exposure to unrecoverable loss. This may have both direct and indirect costs to Council. However, in some areas, insisting on unlimited supplier liability may be a barrier for suppliers to participate, particularly smaller firms. It may also reduce market competition and/or increase the price.

Council should take a risk-based approach to considering whether to agree to an exclusion or limitation on liability by a supplier (this is an important aspect of achieving value for money). If Council accepts an exclusion or limitation, the contract needs to be very clear about its scope and extent. Where there is an exclusion or limitation on a supplier's liability, Council should take associated costs into account when considering that supplier's works, goods or services. Without a limitation in the contract, the supplier's liability will be determined by the general law.

Equally, Council may decide that it is appropriate, having evaluated the risks, for it to limit its own liability or to seek an indemnity.

Ethical considerations

Council should be ethical and act with integrity when funding or procuring goods or services. Council should:

- act, and be seen to be acting, in a fair, open and unbiased manner; and
- observe ethical standards, principles and behaviour throughout the procurement process.

Conflicts of interest

As part of the general obligation to act fairly, Councils must take care that their decision-making processes cannot be challenged on the basis of actual or potential bias and/or conflicts of interest. These legal obligations will often be mirrored in the ethical standards that govern public sector conduct.

For the local government sector specific rules are set out in the Local Authorities (Members' Interests) Act 1968 that will govern requirements for disclosing and managing conflicts of interest.

Complying with any relevant statutory requirements will not necessarily be enough to ensure that decision-making processes meet the more general public law requirements of fairness. Council must also take steps to ensure that no other aspect of the process could be tainted by a conflict of interest arising outside of those processes regulated by statute. For example, the statutory requirements tend to be confined to the declaration and management of conflicts of interest by members of a governing board or council. But conflict problems might also arise as a result of the interests or associations of officials, staff members or other participants in the procurement process.

The Office of the Auditor General has produced two guides on conflict of interest issues to assist public entities:

- **Managing conflicts of interest : Guidance for public entities** applies to all public entities and sets out an approach for dealing with conflict of interest issues when they arise. It includes a number of case studies.
- **Guidance for members of local authorities about the law on conflicts of interest** has been developed specifically for local authorities and other entities that are subject to the Local Authorities (Members' Interests) Act 1968.

Council staff should be aware of the potential for conflicts of interest for every staff member and adviser who is directly or indirectly involved in any aspect of the process. This includes governance, management, operational staff and Council as the approving authority itself.

All staff, advisors and officials (including elected members) involved in the procurement process are required to declare any personal interest that may affect, or could be perceived to affect, their impartiality. Council will then need to decide what steps are necessary to manage the conflict, having regard to any relevant statutory requirements.

Conflicts of interest can have both legal and ethical dimensions. Under no circumstances should a procurement process allow a Council's staff to receive preferential treatment. Gifts, hospitality or other incentives from suppliers should be subject to Council's Code of Conduct, which should comply with the **Standards of Integrity and Conduct** published by the State Services Commission. A copy of this code is on the State Services Commission's website (www.ssc.govt.nz).

Concerns may arise, for example, if a person (including staff, advisors, officials and elected members) who is managing a current contract has received gifts or hospitality from the supplier, and then participates in the selection process for a new contract.

Council will maintain a register of declarations of conflicts of interest that records any conflicts of interest and how they will be managed.

Confidentiality

Confidentiality is a common characteristic of any competitive procurement process. Council should take particular care when handling commercially sensitive information. Council should note that confidentiality obligations apply throughout the entire procurement process and also after the contract has terminated or expired.

Council may face particular risks in its handling of confidential information when it funds or procures works, goods or services in a statutory context. Council may, for example, have a statutory obligation to consult third parties in the course of procuring works, goods or services. This may require Council to disclose some information that it has received from potential suppliers.

Council will also need to consider its obligations under either the Official Information Act 1982 or the Local Government Official Information and Meetings Act 1987. These Acts mean that Councils are not able to give comprehensive assurances about the protection of sensitive information. There are relevant grounds for withholding information under those Acts, such as unreasonable prejudice to the commercial position of a potential supplier, but these can be over-ridden if there is a greater public interest in disclosing the information.

Selection of procurement methods for works, goods and services

Overview

Selecting the type and/or form of contract will depend on the value and complexity of the purchase as well as the nature of the works, goods or services being funded or procured. It will also depend upon the uncertainties that may be involved in contract performance and the extent to which the Council or the supplier is to assume the risk of the cost of performance of the contract. Contracts differ in the degree of responsibility assumed by the supplier.

When choosing the appropriate procurement method it is noted that some methods are governed by legislation. For example, the Land Transport Management Act 2003 requires certain procedures to be used for approved activities relating to transport.

Where there is no statutory requirement to use a particular method, Council needs to decide the procurement method it will use. To ensure that the benefits of the method outweigh the costs, it is expected that Council, when selecting the procurement method, will consider:

- the need, wherever possible, to promote open and effective competition throughout the procurement process; and
- the value of and risk associated with the procurement.

Contract requirements

Council's procurement contracts should:

- be comprehensive enough to meet the objectives of the procurement
- reflect the full specification of the works goods or services
- be consistent with the conditions specified for the procurement process
- define and protect the rights and obligations of all parties
- be consistent with Council's statutory functions, duties and powers
- be fair to both parties and pass the "sense test" or "reality check" particularly where clauses cover limitations or exclusions of liability, indemnities, warranties and intellectual property.

Contract terms

The contract terms should be included in the procurement documents and respondents should be required to confirm whether they would accept the proposed contract terms (or propose alternative terms).

The contract terms should comply with relevant public sector constraints for example, the contract may not be able to contain indemnities and cannot contract out of the Official Information Act 1982.

Factors to be considered in selecting types of contract

Council will note the factors that should be taken into account when selecting the type of contract, for example:

- the nature of the works, goods or services
- the type and complexity of the procurement
- the likely administrative costs for both parties
- any likely difficulty in clearly defining the contract requirements
- how much technical or operational coordination Council will need to provide
- the intended duration of the contract
- the likely volatility of cost inputs; and
- the extent of risk that either party will have to assume.

Scope of procurement

The works, goods or services must be clearly specified before procuring them. If Council is using a competitive proposal process and is open to innovation, the specification may focus on the outputs and outcomes rather than the process to be followed to deliver the outputs or outcomes.

The specification should contain a clear, concise, logical and accurate description of the works goods or services being procured. This will help potential suppliers and those who will be involved in making the procurement decision.

Contract value

As noted, Council requires that all procurement of works, goods or services valued at **\$50,000** will be subjected to a competitive procurement process and the type of process (for example, seeking quotations or using a tender or proposal process), will take into account the level of risk and the type of works, goods or services to be procured.

For clarification the value of **\$50,000** relates to the total cost of the procurement for the works, goods or service. It is not intended that purchases of portions or stages of work under \$50,000 can be carried out to avoid the competitive process. For example, it is not acceptable to create two contracts of, say, \$25,000 each for effectively the one purchase without using a competitive procurement process.

However this may be appropriate where there are two (or more) discrete components of the works, goods or service. For example, the supply of materials separate from the delivery of the works. In these cases the purchases should not be from the same supplier without using a competitive procurement process.

Management and evaluation of procurement processes

The main objective of the procurement process is to achieve a good outcome for Council, that is selecting a supplier that has the capability to deliver the works, goods or services and provides the best value for money. Tender or proposal evaluation models help decide which potential supplier this is.

How Council conducts, manages and evaluates the procurement process is outlined in the Procurement Manual.