

Chapter 2

The Commonwealth Procurement Framework

2.1 This chapter sets out the central elements of the Commonwealth procurement framework which are relevant to this inquiry, namely:

- the Commonwealth Procurement Rules; and
- policies to preference Australian goods and services.

2.2 The chapter also includes some analysis of the engagement of Australian suppliers in Commonwealth procurement and the volumes of Australian goods and services procured by the Commonwealth government.

Commonwealth Procurement Rules

2.3 The Commonwealth Procurement Rules (CPRs) form the core of the Commonwealth procurement framework, setting out the rules for government procurement and articulating the requirements for officials performing duties in relation to procurement.¹ Prior to 1 July 2014 the CPRs were issued under Regulation 7 of the Financial Management and Accountability Regulations 1997 and applied to all agencies that came under the *Financial Management and Accountability Act 1997* (FMA Act), as well as prescribed bodies under the *Commonwealth Authority and Companies Act 1997* (CAC Act).² From 1 July 2014, with the introduction of the *Public Governance, Performance and Accountability Act 2013* (PGPA Act) the CPRs will form part of the PGPA Act rules and are issued by the Minister for Finance under section 105B(1) of the PGPA Act.³

2.4 The evidence to this inquiry related to the CPRs and the Commonwealth Financial Framework as it existed prior to 1 July 2014. For this reason, the references in this report are to the CPRs which were issued on 1 July 2012. While the CPRs issued in July 2014 largely replicate the previous CPRs, any significant differences are noted in the committee's report.

2.5 In addition to the CPRs, the Commonwealth procurement framework also includes:

- web based guidance, developed by the Department of Finance to assist agencies to implement the procurement framework;

1 Paragraphs 2.2 and 2.4 of the Commonwealth Procurement Rules (CPRs), 1 July 2012.

2 Paragraph 2.1 of the CPRs, 1 July 2012 and Department of Finance, *Submission 12*, p. 2. The CPRs issued pursuant to the Financial Management and Accountability Regulations 1997 were a legislative instrument under section 64(3) of the *Financial Management and Accountability Act 1997* (FMA Act). See Dr Nick Seddon, *Submission 1*, p. 2.

3 See Forward to the Commonwealth Procurement Rules, July 2014, p. 3; Department of Finance, *Submission 12*, p. 2.

- Finance Circulars which advise of key changes and developments in the procurement framework; and
- Chief Executive Instructions, which a Chief Executive may use to set out agency specific operational rules to ensure compliance with the rules of the procurement framework.⁴

2.6 The procurement framework has been devolved which means the responsibility for spending public money rests with agencies, Chief Executives and their delegates. Any non-compliance with the CPRs is required to be reported in the annual Certificate of Compliance process.⁵

Structure of the CPRs

2.7 The CPRs are divided into two parts. Division 1 of the CPRs sets out the rules that are applicable to all procurements, regardless of their value or whether an exemption from Division 2 applies to them, and are grouped according to the following areas:

- value for money;
- encouraging competition;
- efficient, effective, economical and ethical procurement;
- accountability and transparency;
- risk management; and
- procurement method.

2.8 Division 2 of the CPRs provides additional rules for procurements at or above the relevant procurement threshold, which was \$80,000 for FMA Act agencies, other than for procurements of construction services; and \$400,000 for relevant CAC Act

4 Paragraph 2.4 of the CPRs, 1 July 2012; Department of Finance, *Submission 12*, pp 2-3. Paragraph 2.4 of the CPRs, July 2014, also states that the CPRs are the core of the procurement framework, which also includes web-based guidance, developed by the Department of Finance to assist agencies to implement the procurement framework; and 'Resource Management Guides' which advise of key changes and developments in the procurement framework (these appear to replace the Finance Circulars referred to in the earlier CPRs). The CPRs issued in July 2014 do not refer to Chief Executive Instructions, but rather 'Accountable Authority Instructions' which can be used to set out entity-specific operational rules to ensure compliance with the rules of the procurement framework (paragraph 2.5 of the CPRs, July 2014).

5 Department of Finance *Submission 12*, p. 5. The Certificate of Compliance Report informs the Parliament of the outcomes of the annual Certificate of Compliance process for agencies under the *Financial Management and Accountability Act 1997*. See www.finance.gov.au/publications/certificate-of-compliance-report/ (accessed 4 April 2014). The committee did not receive evidence on the compliance reporting arrangements which will exist under the PGPA Act. However the committee understands that there is a draft guidance issued, dated 17 June 2014, which outlines proposed requirements for compliance reporting for the 2014-15 year. This is applicable to non-corporate Commonwealth entities, available at: <http://www.pma.finance.gov.au/#ref1> (accessed 7 July 2014).

bodies, other than for procurements of construction services.⁶ Appendix A of the CPRs provides a list of procurements which are exempt from Division 2 rules but are still required to be undertaken in accordance with value for money and the rules contained in Division 1 of the CPRs.

Value for money

2.9 The CPRs provide that the core principle applied to all procurements is that there must be value for money:

Value for money in procurement requires:

- a. encouraging competitive and non-discriminatory processes;
- b. using Commonwealth resources in an efficient, effective, economical and ethical manner that is not inconsistent with the policies of the Commonwealth;
- c. making decisions in an accountable and transparent manner;
- d. considering the risks; and
- e. conducting a process commensurate with the scale and scope of the procurement.⁷

2.10 At the first public hearing Mr John Sheridan, First Assistant Secretary, Technology and Procurement Division, Business, Procurement and Asset Management Group, Department of Finance, reiterated the importance of value for money in the procurement process:

The key principle of the Commonwealth's procurement framework is to achieve value for money through competitive, open, transparent, efficient and publicly accountable processes.⁸

2.11 The CPRs explicitly provide that, in assessing value for money, the price of goods and services is not the sole determining factor:

A comparative analysis of the relevant financial and non-financial costs and benefits of alternative solutions throughout the procurement will inform a value for money assessment. Factors to consider include, but are not limited to:

- a. fitness for purpose;
- b. a potential supplier's experience and performance history;
- c. flexibility (including innovation and adaptability over the lifecycle of the procurement);

6 Paragraph 3.3 of the CPRs, 1 July 2012. Paragraph 9.7 of the CPRs, July 2014, provide that for non-corporate Commonwealth entities the procurement threshold, other than for procurements of construction services, is \$80,000; for prescribed corporate Commonwealth entities the procurement threshold, other than for procurements of construction services, is \$400,000.

7 Paragraph 4.4 of the CPRs, 1 July 2012.

8 *Committee Hansard*, 21 March 2014, p. 57.

- d. environmental sustainability (such as energy efficiency and environmental impact); and
- e. whole-of-life costs.⁹

Encouraging competition and non-discriminatory processes

2.12 Paragraph 5 of the CPRs focus on the encouraging competition and non-discriminatory processes aspect of the principle of value for money in procurements:

Competition is a key element of the Australian Government's procurement framework. Effective competition requires non-discrimination and the use of competitive procurement processes.¹⁰

...

The Australian Government's procurement framework is non-discriminatory. All potential suppliers to government must, subject to these CPRs, be treated equitably based on their commercial, legal, technical and financial abilities and not be discriminated against due to their size, degree of foreign affiliation or ownership, location, or the origin of their goods and services.¹¹

Commonwealth procurement and bilateral trade agreements

2.13 Australia is a party to a number of bilateral free trade agreements which, to some extent, cover government procurement. These agreements have no effect unless implemented in domestic legislation.¹² The CPRs incorporate relevant international obligations arising from bilateral free trade agreements, including the Australia-United States Free Trade Agreement (AUSFTA), therefore an official undertaking a procurement are not required to refer directly to international agreements.¹³

Exemptions and preferencing local suppliers

2.14 In its submission the Department of Finance (Finance) notes that, pursuant to commitments in Australia's free trade agreements, the Commonwealth government is obligated to 'open up access to our procurement market' and '[t]hese commitments limit the extent to which the Commonwealth Government can preference local suppliers'.¹⁴

9 Paragraph 4.5 of the CPRs, 1 July 2012. Paragraph 4.5 of the CPRs, July 2014, include an additional factor in this list – the quality of goods and services. This additional factor is discussed further in Chapter 4 of the report.

10 Paragraph 5.1 of the CPRs, 1 July 2012.

11 Paragraph 5.3 of the CPRs, 1 July 2012.

12 See Dr Nick Seddon, *Submission 1*, pp 1-2.

13 See Paragraph 2.15 of the CPRs, 1 July 2012. This provision is set out at Paragraph 2.14 of the CPRs, July 2014. Chapter 15 of the Australia-United States Free Trade Agreement (AUSFTA) deals with Government Procurement. In his submission Dr Seddon notes that the CPRs are 'a close copy of Chapter 15 [of the AUSFTA]', *Submission 1*, pp 1-2.

14 *Submission 12*, p. 3.

2.15 For example, the AUSFTA provides:

Each Party and its procuring entities shall accord unconditionally to the goods and services of the other Party and to the suppliers of the other Party offering the goods or services of that Party, treatment no less favourable than the most favourable treatment the Party or the procuring entity accords to domestic goods, services and suppliers.¹⁵

A procuring entity of a Party may not:

(a) treat a locally established supplier less favourably than other locally established suppliers on the basis of degree of foreign affiliation or ownership; nor

(b) discriminate against a locally established supplier on the basis that the goods or services offered by that supplier for a particular procurement are goods or services of the other Party.¹⁶

...

A procuring entity may not seek, take account of, impose, or enforce offsets in the qualification and selection of suppliers, goods, or services, in the evaluation of tenders or in the award of contracts, before or in the course of a covered procurement.¹⁷

...

offsets means any conditions or undertakings that require use of domestic content, domestic suppliers, the licensing of technology, technology transfer, investment, counter-trade, or similar actions to encourage local development or to improve a Party's balance-of-payments accounts.¹⁸

2.16 This prohibition on preference for local content is reflected in the CPRs in the non-discrimination principle (paragraph 5.3 of the CPRs).

2.17 However, Finance did refer to some exemptions in the CPRs that allow the government to engage directly with Australian industry, while ensuring the principle of achieving value for money is met. Those exemptions include procurements relating to:

- property or accommodation (but not construction services);
- motor vehicles;
- suppliers that primarily exist to provide the services of persons with a disability; and

15 Articles 15.2(1) of the AUSFTA.

16 Article 15.2(2) of the AUSFTA.

17 Article 15.2(5) of the AUSFTA.

18 Article 15.15 of the AUSFTA (Definitions).

- suppliers that are SMEs with at least 50 per cent Indigenous ownership.¹⁹

2.18 Under chapter 15 of the AUSFTA, certain military purchases are also exempt from the requirements not to preference local business. This list is not reproduced in the CPRs, but can be found in the Defence Procurement Policy Manual.²⁰

Small and Medium Enterprises

2.19 Finance noted that Australia's international trade agreements do allow for policies that benefit Small and Medium Enterprises (SMEs).²¹ The AUSFTA provides that the provisions in the agreement in relation to government procurement do not apply to 'any form of preference to benefit small and medium enterprises'.²²

2.20 In relation to SMEs, paragraph 5.4 of the CPRs states:

To ensure that Small and Medium Enterprises (SMEs) can engage in fair competition for Australian Government business, officials should apply procurement practices that do not unfairly discriminate against SMEs and provide appropriate opportunities for SMEs to compete. Officials should consider, in the context of value for money:

- a. the benefits of doing business with competitive SMEs when specifying requirements and evaluating value for money;
- b. barriers to entry, such as costly preparation of submissions, that may prevent SMEs from competing;
- c. SMEs' capabilities and their commitment to local or regional markets; and
- d. the potential benefits of having a larger, more competitive supplier base.²³

2.21 Dr Nick Seddon, a lawyer and academic specialising in government contracts, indicated that, in his view, the provision regarding SMEs in the CPRs is 'not very well drafted'. Specifically:

[T]hey say that government agencies, when making purchasing decisions, must not discriminate against SMEs. That does not answer the question: can they discriminate in favour of SMEs—that is, give them a bit of a boost?

19 *Submission 12*, p. 4. These exemptions are contained in Appendix A of the CPRs and reflect exemptions provided for under the AUSFTA.

20 Dr Nick Seddon, *Submission 1*, p. 4. Dr Seddon notes the list in the Defence Procurement Policy Manual (DPPM) copies the list in chapter 15 of the AUSFTA but is presented in the DPPM as determined by the Secretary of Defence and CEO Defence Materiel Organisation as exempt under a general rule in the CPRs, namely paragraph 2.6 of the CPRs. This list is reproduced at Appendix 3.

21 *Submission 12*, p. 4. The CPRs define SMEs as 'an Australian or New Zealand firm with fewer than 200 full-time equivalent employees', see Appendix C (Definitions) of the CPRs, 1 July 2012. The Definitions are in Appendix B of the CPRs, July 2014.

22 Section 7 of Chapter 15 of the AUSTFA, General Notes, Schedule of Australia.

23 Paragraph 5.4 of the CPRs, 1 July 2012.

The crunch would be in a case where you have submissions in a tender process and an SME is in the running and is a bit more expensive or maybe is not quite as good value for money but is an SME. A question then arises: can a decision be made to give the contract to that SME and, in that sense, discriminate in favour of an SME? The CPRs are not clear on that...²⁴

2.22 Dr Seddon argued if the CPRs are read in the context of the provisions of the AUSFTA 'it is pretty clear that deciding whether to grant a contract to an SME is exempt from the basic principle that you should not give local preference'.²⁵ However, Dr Seddon did acknowledge that the AUSFTA should not be used as an aid to assist in the interpretation of the CPRs.²⁶

2.23 The CPRs include a commitment for FMA Act Agencies sourcing at least 10 per cent of procurement by value from SMEs.²⁷ By way of example, the Department of Industry provided the committee with its SME participation statistics:²⁸

Supplier Group	by Value (\$)	% by Value	by Number	% by Number
SME	\$146,537,320	65	949	63
Other	\$78,853,962	35	568	37
Total	\$225,391,282	100	1517	100

2.24 The Department of Industry noted that the overall SME participation rate across whole of government in 2012-13 was 31.7 per cent.²⁹

Policies to assist industry participation

2.25 Finance stated that the Commonwealth Government 'has a range of policies and initiatives in place to support Australian industry participation in government procurement'.³⁰

2.26 A number of these policies come within the Australian Industry Participation (AIP) policies and programs, which are administered by the Department of Industry. These programs and policies:

[E]ncourage full, fair and reasonable opportunity for Australian industry to compete for work in major public and private sector projects. AIP

24 *Committee Hansard*, 28 April 2014, p. 1.

25 *Committee Hansard*, 28 April 2014, p. 1.

26 *Committee Hansard*, 28 April 2014, p. 2.

27 Department of Finance, *Submission 12*, p. 4. See Paragraph 5.5 of the CPRs, July 2014, which provides that the government is committed to non-corporate Commonwealth entities sourcing at least 10 per cent of procurement by value from SMEs.

28 *Submission 36*, p. 2.

29 *Submission 36*, p. 3. See also Department of Finance, *Submission 12*, p. 5.

30 *Submission 12*, p. 8.

programmes also support the matching of capable and competitive Australian companies with supply opportunities in major projects.³¹

2.27 The AIP policies and programs include:

- AIP Plans in Commonwealth Government Procurement – tenderers for large Commonwealth procurements (over \$20 million) are required to prepare and implement AIP Plans which outline actions a tenderer will take to provide Australian suppliers, especially SMEs, with access to supply opportunities in the project.³²
- Supplier Advocates – which provide leadership and coordination to improve the competitiveness of SMEs in targeted industry sectors and help them connect with new business opportunities.³³
- The Buy Australian at Home and Abroad initiative – which assists Australian firms to enhance their competitiveness and link with new business opportunities, particularly on major projects both in the public and private sector.³⁴

Australian supplier engagement in government procurement

2.28 In its submission, Finance provided detailed analysis from AusTender of the number of Australian suppliers in government procurement processes. This data 'indicates that Australian suppliers are competitive on their own merits in winning contracts'.³⁵ Finance provided the following statistics on value and participation of SME involvement in Commonwealth procurement for 2012-13:

- from the 67,854 contracts awarded, there were 11,460 suppliers contracted, 10,212 (89.1%) of which were SMEs; and

31 Department of Industry website, available at: www.industry.gov.au/industry/AustralianIndustryParticipation/Pages/default.aspx (accessed 23 June 2014).

32 Department of Industry, *Submission 36*, p. 6.

33 The targeted industry sectors are: rail; steel; information technology; clean technologies; water; textiles, clothing footwear; food and beverage; and medical and scientific technologies, see Department of Industry website at: www.industry.gov.au/industry/AustralianIndustryParticipation/SupplierAdvocates/Pages/default.aspx (accessed 23 June 2014).

34 Department of Industry website, available at: www.industry.gov.au/industry/BuyAustralianatHomeandAbroad/Pages/AbouttheInitiative.aspx (accessed 23 June 2014). Note: Funding for these measures will be discontinued from 31 December 2014. See Senate Economics Committee, *Estimates Hansard*, 3 June 2014, p. 80.

35 *Submission 12*, p. 4. AusTender is the Australian Government's procurement information system, see www.tenders.gov.au/ (accessed 22 May 2014).

- the value of the 67,854 contracts awarded was \$39.3 billion in total, of which SME participation was 31.7% (\$12.5 billion) of the total contracts by value and 60.5% (41,032) of the total number of contracts.³⁶

2.29 Finance also provided information on the provision of goods and services by Australian suppliers:

- 82.4% of goods and services, by value purchased by the Commonwealth Government are likely to have been sourced from Australia suppliers, or in the case of services, delivered by Australian suppliers;
- 92.0% of services are likely to have been sourced from Australian suppliers; and
- 70.1% of goods are likely to have been sourced from Australian suppliers.³⁷

2.30 However, at the first public hearing, Mr Sheridan, representing the Department of Finance, explained the technical difficulty in determining whether goods or content are sourced from 'Australian' suppliers:

This is because AusTender data includes the [Australian Business Number (ABN)], where that is available, of each supplier and their business addresses. These two identifiers are the only information that can be used to determine whether goods or services are sourced from Australian suppliers. In order to increase the accuracy of Australian-supplied statistics, we would need to impose additional onerous reporting requirements on suppliers in relation to the content of goods and services being supplied under each contract. This would introduce a significant amount of red tape for suppliers.

A consensus definition of what is Australian is also difficult to achieve, because, for example, goods may be made up of components from various sources.³⁸

2.31 Mr Sheridan stated that, despite these limitations, Australian suppliers are competitive:

Australian suppliers...win the vast majority of Commonwealth contracts without the need for restrictions or other mechanisms that may impact these same businesses competing overseas. For instance, Australian and New Zealand small to medium enterprises win more than half of government contracts, some 60 per cent of those awarded each year.³⁹

36 *Submission 12*, p. 4. This data is based on reporting of procurement contracts, valued at \$10 000 or greater, on AusTender in 2012-13.

37 *Submission 12*, p 5. In terms of the breakdown of goods and services in the total contracts – goods accounted for 43.8% by value (\$17.2 billion); services accounted for 56.2% by value (\$22.1 billion); and of the total number of contracts reported, 69.8% were valued below \$80,000 equating to 3.7% of the total value of all contracts awarded.

38 *Committee Hansard*, 21 March 2014, pp 57-58.

39 *Committee Hansard*, 21 March 2014, p. 58.

Committee view

2.32 The committee has serious concerns that an ABN is not a good indication of whether goods are manufactured in Australia. Further, having an ABN does not enable a distinction to be drawn between a supplier and a manufacturer, whether goods are wholly imported or the quantity of Australian content.

2.33 The committee is also not convinced that seeking information, in addition to an ABN, from Australian businesses as to whether goods are manufactured in Australia will in fact increase the regulatory burden on these businesses. The committee therefore recommends that this assertion, that increasing the accuracy of data would impose onerous reporting requirements on suppliers, be tested with Australian industry, and specifically, with Australian manufacturers.

Recommendation 1

2.34 The committee recommends that the Department of Finance (Australian Government Procurement Coordinator) consult with Australian industry, and in particular Australian manufacturers, to develop an alternate test which can provide more meaningful information on the quantity of Australian content in goods and services procured by the Commonwealth government, and how to build this information into data collected in AusTender.

Procurement-connected policies

2.35 The CPRs refer to 'procurement-connected' policies as 'policies of the Commonwealth for which procurement has been identified as a means of delivery'.⁴⁰ While Finance maintains a list of procurement-connected policies, the CPRs state:

Many of these procurement-connected policies are the responsibility of agencies other than Finance. The policy agency is responsible for administering, reviewing and providing information on the policy as required.⁴¹

2.36 There are currently 24 procurement-connected policies, relating to different industry groups.⁴² Examples of procurement-connected policies include:

- Australian Industry Participation Plans for Government Procurement, administered by the Department of Industry;
- Procurement On-Time Payment Policy for Small Business, administered by the Department of Finance;
- Legal Services Directions, administered by the Attorney-General's Department;

40 Paragraph 4.6 of the CPRs, 1 July 2012.

41 Paragraphs 4.6 and 4.7 of the CPRs, 1 July 2012.

42 Ms Yvette Sims, Department of Finance, *Committee Hansard*, 21 March 2014, p. 63. A full list of procurement-connected policies, the department responsible for the policies, the year the policy was initiated, the suppliers affected and the threshold applicable to the policy are set out in Appendix 4.

- Commonwealth Disability Strategy, administered by the Department of Social Services;
- Energy Efficiency in Government Operations, administered by the Department of Industry;
- ICT Sustainability Plan 2010-2015, administered by the Department of the Environment; and
- The National Waste Policy, administered by the Department of the Environment.

