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## SUBMISSION: COMMONWEALTH PROCUREMENT

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### 1 Introduction

#### 1.1 Introduction

This is a submission to the Joint Committee of Public Accounts and Audit on its inquiry into Commonwealth procurement.

The inquiry is to have particular regard to:

- (a) matters contained in or connected with 5 Auditor-General's reports<sup>1</sup>
- (b) the views of the Auditor-General, Department of Finance and other interested parties in relation to Commonwealth procurement and demonstrating value for money through competition, probity, and strong contract management.

In the 2021-22 financial year, the Commonwealth reported on AusTender 92,303 contracts to a total estimated value of \$80.8bn. Procurement of services accounted for 61.02% of these contracts.

#### 1.2 Themes from the Auditor-General's reports

There are a number of clear themes running through the Auditor-General's reports:

- (a) issues with evaluation and evaluation criteria
- (b) inadequate understanding of probity issues and risks, and their management
- (c) ineffective contract administration and management (including managing contractors' performance)
- (d) inadequate record-keeping and recording of the basis of procurement decisions.

#### 1.3 Our main points

A summary of our suggestions:

- (a) **AusTender** could be reformed to make it easier, more intuitive and better able to provide more effective information to industry and government about procurement activities - it could also evolve to be a tender management system, with certain aspects of the process automated
- (b) responsibility for agencies' procurements should continue to be **devolved** to agencies - with a further investment in centralised support for those agencies
- (c) it should be a requirement that each procurement over a specified threshold have clearly specified **procurement objectives**
- (d) it should be a requirement that each procurement over a specified threshold develop a **detailed procurement plan**

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<sup>1</sup> No. 6 (2021-22) *Management of the Civil Maritime Surveillance Services Contract*; No. 15 (2021-22) *Department of Defence's Procurement of Six Evolved Cape Class Patrol Boats*; No. 30 (2021-22) *Procurement by the National Capital Authority*; No. 42 (2021-22) *Procurement of Delivery Partners for the Entrepreneurs' Programme*; No. 5 (2022-23) *Digital Transformation Agency's Procurement of ICT Related Services*.



- (e) agencies that do not already have detailed **risk management** frameworks that apply to procurements should develop and apply them
- (f) it should be mandatory to use (and publish) **evaluation criteria** for all procurements over a specified threshold
- (g) there should be an increased emphasis on **contract administration**, including in the Commonwealth Procurement Rules
- (h) the Commonwealth Procurement Rules should be amended to provide more detailed guidance on **probity issues** in procurement, in particular in relation to conflicts of interest and their management.

#### 1.4 About King & Wood Mallesons

The views and conclusions in this submission are based on our lawyers' extensive experience in acting for Commonwealth agencies in major procurements over many years.

We have been involved in procurements that are '*high value, high risk*' and '*low value, but high risk*'.

It is unusual for us to be involved in procurements that are low risk, low value, except in so far as the procurement is the standing up of a legal framework under which agencies can enter into contracts (where it is important that the legal framework gives the agency the legal rights and remedies it will need).

Our team members have a deep understanding, born of long experience, of the key legal and commercial issues for Commonwealth procurements and the management of procurement risk.

We also have extensive experience acting for State and Territory Governments on major procurements, including major infrastructure projects.

## 2 AusTender improvements

**We recommend** that the Committee consider whether a further investment in the AusTender platform would assist in increasing the efficiency and effectiveness of Commonwealth procurement processes. Currently, AusTender is used solely as a platform communicating Commonwealth opportunities and through which tenders are lodged. We are not aware of the platform having any capability to assist agencies to assess or otherwise process tenders.

An "enhanced" AusTender platform could be programmed to:

- (a) assist agencies in assessing whether the minimum form and content requirements are satisfied - and communicate outcomes directly to tenderers, saving agencies from expending effort in assessing tenders as compliant or not on that basis
- (b) if the suggestion at paragraph 3.3(d) is adopted - verify for agencies the status of tenderers under those Programs (or their equivalents)
- (c) assist in ensuring Request for Tender meet the requirements of the CPRs - eg minimum time requirements and consistent evaluation criteria across multi stage procurements
- (d) assist in identifying tender non-compliances,
- (e) confirm proper execution under section 127 of the Corporations Act by directors, and
- (f) provide procurement information about the range and scope of procurements more easily than at present.

We expect that detailed consideration of the pain points of procurements (for both tenderers and suppliers) would reveal further functionality that would represent time-saving measures for agencies and tenderers, including potentially using AI to assess certain aspects of tenders (similar to that used by law firms for certain due diligence).



### 3 Decentralised purchasing responsibility

#### 3.1 Decentralised purchasing should be retained

Commonwealth procurement is conducted on a decentralised basis, that is, each agency is responsible for its own procurement activities.<sup>2</sup>

It is a bedrock principle of the *Public Governance, Performance and Accountability Act 2013* that the accountable authority of a Commonwealth agency has an obligation to govern the entity in a way that:

- (a) promotes the proper use and management of public resources for which the authority is responsible; and
- (b) promotes the achievement of the purposes of the entity; and
- (c) promotes the financial sustainability of the entity.<sup>3</sup>

This extends to procurements. In the context of procurements, it means that value for money must be achieved.<sup>4</sup>

Given the enormous scope of the procurements the Commonwealth undertakes - everything from buttons to battleships - we consider a decentralised procurement system is appropriate if value for money is to remain a core requirement of Commonwealth procurement policy and law.

Whether value for money has been achieved is a matter of judgment, taking a holistic view of the entire transaction and asking: *is what I'm getting worth the money, given the procurement's objectives?* In effect, a value for money assessment is a cost-benefit analysis, balancing price and the ability of the tendered solution to meet the agency's identified business needs. The agency is best placed to make these judgments.

#### 3.2 A centralised arrangement?

We are aware that at least 1 submission has advocated for a centralised arrangement, at least in relation to ICT procurements, involving, as we understand it, the establishment of an independent commercial entity to develop leading procurement practices and overall supply strategies as well as conducting procurements.<sup>5</sup>

There are number of matters that would have to be considered in terms of the interaction of such an entity with the Commonwealth accountability framework, for example:

- (a) whether the procuring entity would be a Commonwealth entity for the purposes of the *Public Governance, Performance and Accountability Act 2013*, or a contracted non-government entity
- (b) which entity would have the obligation to achieve value for money? If it's the procurement entity, how will it fully understand the nature of the goods or services to be acquired so that it can make value for money judgments? It may need to be relieved of the duty to achieve value for money

So also, the accountable authority of the commissioning agency would need to be explicitly relieved of its duty to achieve value for money for procurements run by the procurement entity, as it would not have control over the negotiation of the terms of the procurement.

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<sup>2</sup> Subject to the obligation of some agencies, and the power of other agencies, to use whole of government arrangements when procuring specified goods and services. Using these arrangements doesn't relieve the agency from the obligation to achieve value for money.

<sup>3</sup> *Public Governance, Performance and Accountability Act 2013* section 15. *Proper* means "efficient, effective, economical and ethical": section 8, definition of *proper*. Each of these terms is elaborated to some extent in the Commonwealth Procurement Rules (CPR 6) and also in Department of Finance guidance.

<sup>4</sup> CPR 4.4.

<sup>5</sup> Hypereal *Submission 8*.



- (c) which entity would carry the risk associated with accepting the supplies as conforming to the procurement contract requirements, or that a payment milestone had been achieved – the entity or the commissioning agency?

- (d) we understand the proposals that

Its funding would come from the revenues currently tithed from agencies ...

means that its operational costs and profit would come from these sources, not the cost payable to vendors. Would this mean that the commissioning agency would be required to meet whatever cost the procurement entity negotiated?

We are conscious that centralised procurement approaches are operated and have been considered by other governments (and indeed is the approach adopted by the Commonwealth in respect of a limited number of services). The lessons from these models may be informative in considering options for centralised procurement models.

### 3.3 However, there are opportunities for more comprehensive centralised support

That is not to say that agencies could not be supported by more investment in centralised support. For example, the Department of Finance currently provides a range of advice to agencies with respect to best practice for procurements. There would be a wider range of areas where agencies would benefit from enhanced support from Finance:

- (a) further detailed training - on:
  - (i) the Commonwealth accountability framework - including official's duties under the *Public Governance, Performance and Accountability Act 2013* (to ensure there is a detailed understanding of the *Public Governance, Performance and Accountability Act 2013* Act framework as it applies to procurement - this is more significant than simply compliance with the CPRs, as there is an inherent connection with the broader risk framework in the Act, and (when the relevant sections come into force) the *National Anti-Corruption Commission Act 2022*)
  - (ii) CPRs best practice and things to avoid. This training would also guide officials on the link between the CPRs and Australia's free trade agreements
  - (iii) leveraging Whole of Australian Government Agreements consistently with the broader accountability framework (including, for example, the extent to which agencies need to test the market when using panels)
  - (iv) corporate practices - many public servants have not had the opportunity to work in the private sector and corporate concepts (such as changes in control) are sometimes not well-understood
  - (v) how to navigate the limited tender flexibility in CPR10.3 with the broader accountability framework (to ensure value for money over the life of the procurement), and
  - (vi) insurances -this is often key to the Commonwealth's assessment of risk and, generally insurances are not an area of expertise in agencies
- (b) further guidance materials - for example, see paragraph 6.4 and on the topics above
- (c) further template development or enhanced clause bank risk adjusted options - beyond the current Commonwealth Contracting Suite for low risk, low value contracts and the DTA's procurement templates (noting that many agencies will develop their own templates)
- (d) centralised relationship and information management for repeat suppliers over a certain threshold - eg one stop shop for Statement of Tax Records, or insurance certificates. In this regard we recommend that the Committee explore a number of Defence Department initiatives with a view to adopting them more widely across Commonwealth procurements, including:



- (i) the Approved Contractor Insurance Program (ACIP) Initiative, which verifies participating Defence suppliers' global / group and local insurance programs for compliance with Defence requirements
- (ii) the Master Guarantee Program, which allows Defence prime contractors with a signed Master Deed of Guarantee and Indemnity to apply it to multiple contracts with Defence, and
- (iii) the Approved Contractor Viability Program, which streamlines financial investigations of participating tenderers (on an ongoing basis).

Given the role of a contracted personnel working within agencies in the delivery of procurements, and their influence on procurement activities, we recommend consideration be given to permitting such personnel to access such training (at their own cost).

## 4 Procurement objectives

### 4.1 Procurement objectives

All procurements will have an objective. Most procurements will have multiple objectives – the larger the procurement, the more this is likely to be so.

Objectives will obviously include getting goods and services to use, but there may be other, wider, policy objectives, such as strengthening specific technical capacities in local industry, employment policy objectives and ensuring self-reliance in particular sectors (“sovereign capability”).

Not all of these will necessarily be consistent.

### 4.2 Articulating procurement objectives

Understanding the procurement objectives is critical to a number of key elements of the procurement:

- (a) the specifications for the goods and services will be driven by the objectives - why we want the goods or services
- (b) the agency's understanding of the risks associated with the procurement will be informed by the procurement objectives - what risks are there to achieving those objectives?
- (c) the evaluation criteria will be designed around ensuring that the objectives will be met by the selected solution.

The Commonwealth Procurement Rules note the need to understand the “goals and purposes” of a procurement in the context of determining value for money<sup>6</sup> but don't provide any guidance on formulating them, or expressly require them to be recorded and endorsed internally.

### 4.3 Recommendation

**We recommend that** the Commonwealth Procurement Rules require officials authorising a procurement:

- (a) to record clearly, and obtain delegate endorsement of, the objectives for the procurement and
- (b) to ensure that the procurement arrangements are directed to achieving those objectives.

Where trade-offs are required between potentially inconsistent objectives, the statement of the objectives should indicate how these trade-offs are to be decided.

This should be *mandatory* for procurements of or up to a specified (relatively low) threshold value and *recommended as best practice* for other procurements.

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<sup>6</sup> CPR 4.1.



## 5 Procurement plans

### 5.1 Formulating procurement plans

CPR 7.8 requires agencies to maintain annual procurement plans on AusTender: “current procurement plan[s] containing a short strategic procurement outlook”.

However, there is no requirement in the Rules to formulate plans for individual procurements.

Many agencies do in fact do this; for example, the Department of Defence will prepare a procurement plan or procurement strategy for significant procurements, signed off by the appropriate delegate. In our experience, they generally provide clear frameworks for conducting and managing complex procurements.

### 5.2 Recommendation

**We recommend that** the Commonwealth Procurement Rules require agencies conducting a procurement to formulate and implement a procurement plan for the procurement. The plan should address the objectives, risks and processes for the procurement.

It should be endorsed by the relevant delegate for the procurement before the issue of any approach to market documentation.

This should be mandatory for procurements of or over a specified (relatively high) threshold value and recommended as best practice for other procurements.

## 6 Risk management

### 6.1 Risk is everywhere

An agency’s task is not to avoid risk, but to manage it appropriately, having regard to policy priorities associated with the procurement.

Risk management is a fundamental duty of accountable authorities. The *Public Governance, Performance and Accountability Act 2013* section 16 says that the accountable authority of a Commonwealth entity must

...establish and maintain an appropriate system of risk oversight and management for the entity.

In an environment of decentralised responsibility for procurements, understanding and managing risk associated with procurements by Commonwealth entities is an integral part of the accountable authority’s duty.

The Commonwealth Risk Management Policy is mandatory for non-corporate Commonwealth entities, and “best practice” for all corporate Commonwealth entities.<sup>7</sup> It has been updated very recently and focusses on embedding systematic risk management into business processes and developing a positive risk culture.<sup>8</sup>

Individual agencies also have their own published risk management policies.<sup>9</sup>

### 6.2 Relevant kinds of risk

A settled framework for understanding risks in the context of a procurement will help agencies and officials identify and analyse relevant risks and identify the appropriate ways to treat them. The main kinds of relevant procurement risks will be:

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<sup>7</sup> Not just those prescribed in the *Public Governance, Performance and Accountability Rule 2014* section 30.

<sup>8</sup> It suggests that this be done by communicating and consulting about risk, understanding and managing shared risk (shared with other agencies), maintaining the capability to manage risks and review and continuous improvement of risk management processes.

<sup>9</sup> For example, the Department of Defence has published *Joint Directive on the Management of Risk in Defence* (30/2015).



- (a) technical risk - the risk that the solution procured won't be technically appropriate over the contract lifecycle and beyond, including by not integrating into other technical solutions developed by the agency
- (b) commercial risk - the risk that the Commonwealth pays "too much" for the goods or services, or that the terms of the procurement give the Commonwealth inadequate rights (for example, as to indemnities, warranty repair or sustainment generally) or lock the Commonwealth in to a particular solution or vendor
- (c) legal / compliance risk - the risk that the Commonwealth is exposed to liability because of the procurement, including in relation to work health and safety, environmental regulation or because of failure to comply with applicable Commonwealth law or policy.

### 6.3 Identifying risks and treatment methods

The Commonwealth Risk Management Framework provides limited guidance to officials in identifying and dealing with risk in connection with procurements.

#### Element Seven

Considering and planning for emerging risks is an important part of the risk management process. Identifying and monitoring emerging risk enables entities to manage the uncertainty and impact of these risks.

Entities should consider seeking a range of perspectives on emerging risks and incorporate the consideration of these emerging risks into their risk management framework and governance arrangements.

CPR 8 requires agencies to establish processes to identify, analyse, allocate and treat risk when conducting a procurement, commensurate with the scale, scope and risk of the procurement. Special mention is made of cyber security risk.<sup>10</sup>

**We recommend that** all agencies establish formal, tailored methodologies for identifying and dealing with risk in the procurement context and train staff in using them.

Use of these methodologies should be **mandatory** for procurements of or over a specified threshold value.

### 6.4 Allocating risk in procurements

CPR 8 states the appropriate basic principle: risks should be borne by the party best placed to manage them.

The party that controls the work is generally best placed to manage the risks associated with the work. The Commonwealth can't be expected to know what happens on the shop floor.

Nevertheless, in terms of *capacity* to bear the consequences of a risk, the Commonwealth will on occasion be better placed than the contractor. For example, where the losses associated with a particular contract default that itself is a low probability risk are excessive and, perhaps, beyond the realistic capacity of the contractor to bear (even with insurance), it may be appropriate for the Commonwealth to carry a proportion of the loss itself.<sup>11</sup>

There are many methods for allocating risk in contracts, including:

- (a) allocating by contract responsibility for work and delivery of conforming supplies
- (b) dividing the work up, using milestones, checkpoints and "gates" so that the Commonwealth can get advance notice of potential issues

<sup>10</sup> Again, the Department of Defence has a well-established methodology for identifying risk associated with procurements: the liability risk assessment template tool. It's accessible at <https://www.defence.gov.au/business-industry/procurement/policies-guidelines-templates/liability-risk-management>.

<sup>11</sup> Naval sustainment and maintenance provides an example: a sustainment contractor that negligently causes a fire on the ship that destroys the ship, and also destroys the ship alongside.



- (c) use of financial and other security arrangements
- (d) insurance requirements
- (e) step in rights, under which the Commonwealth is entitled to step in and take over the contractor's work for a period.

Not all will be appropriate on all circumstances.

Essentially, working out the allocation of liability and how it is to be allocated is the key ingredient in developing the commercial model for the procurement. But there is little formal guidance (other than in agencies' template procurement contracts and the restrictions on the Commonwealth's granting indemnities<sup>12</sup>) on this.

**We recommend** that the Department of Finance develop further and more detailed guidance on methods of allocating risk and liability in procurement contracts, including on when it is appropriate to adopt particular methods.

### 6.5 Proportionate liability

The proportionate liability regime<sup>13</sup> has the effect, where it applies, of limiting a contracting principal's ability to recover damages for losses flowing from a contractor breach to the level of responsibility of the contractor for the breach. It is for the contracting principal to pursue and recover the balance of the loss from other parties that may have had a responsibility for the loss.

For example, a contractor could disclaim liability for a loss to the extent that it was caused by a subcontractor.<sup>14</sup>

Commonwealth contracts usually adopt ACT law as the governing law of the contract; under the ACT legislation, it's not possible to contract out of the scheme. Under NSW law it is.

The scheme is inappropriate for major Commonwealth procurements, where considerable effort is spent in devising, negotiating and agreeing the commercial model and the risk allocation. It distorts the relationship between principal and contractor and imposes additional costs and risk on the principal.<sup>15</sup>

In our experience, agencies' understandings of the application of these schemes can vary significantly. Consideration should be given, at least to amending the CPRs (which are a legislative instrument and so a federal law) to disapply the State and Territory proportionate liability laws. The parties can agree an allocation of risk and liability that corresponds to the proportionate liability regime if they wish.

## 7 Evaluation criteria

Devising appropriate evaluation criteria for a procurement in our view is essential to a successful procurement. It focusses the agency's mind on the purpose of the procurement, and on how to decide whether the agency's requirements for goods and services will be met. It tends to ensure that agencies will pay attention to factors other than price.<sup>16</sup>

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<sup>12</sup> *Public Governance, Performance and Accountability Act 2013* sections 60, 61. The Department of Finance has detailed guidance on indemnities, warranties and guarantees by the Commonwealth: *Indemnities, guarantees and warranties by the Commonwealth* (RMG 414).

<sup>13</sup> *Civil Liability Act 2002* (NSW) Part 4, *Wrongs Act 1958* (Vic) Part IVAA, *Civil Liability Act 2002* (WA) Part 1F, *Civil Liability Act 2003* (Qld) Chapter 2, Part 2, *Civil Law (Wrongs) Act 2002* (ACT) Chapter 7A, *Proportionate Liability Act 2005* (NT), *Law Reform (Contributory Negligence and Apportionment of Liability Act) 2001* (SA), Part 3, *Civil Liability Act 2002* (Tas) Part 9A, *Competition and Consumer Act 2010* Part VIA, *Corporations Act 2001* Part 7.10, Div 2A, *Australian Securities and Investments Commission Act 2001* Part 2, Division 2, Subdivision GA.

<sup>14</sup> To be able to recover from the contractor, the principal would have to establish that the contractor had a duty under the contract to supervise its subcontractors and had failed to perform that duty.

<sup>15</sup> For example, the principal bears the risk of subcontractors' and third parties' performance.

<sup>16</sup> See CPR 4.4.





CPR 10.35 requires a contract worth more than \$80,000 to be awarded to the tenderer that provides the best value for money *as determined in accordance with the stated evaluation criteria*.

The CPRs are inconsistent in their requirements in relation to evaluation criteria. CPR 7.12 (in Div 1) states

Relevant entities should include relevant evaluation criteria in request documentation to enable the proper identification, assessment and comparison of submissions on a fair, common and appropriately transparent basis

The Commonwealth Contract Suite, mandated for use by non-corporate Commonwealth entities for procurements below \$200,000, does not include evaluation criteria.

However, in all procurements where a decision has to be made, there are factors (criteria) that the agency will apply to determine which response provides best value for money. It's obvious that these should be explicit, to guide officials making this decision. So also, they should be communicated to potential respondents, so that they can be explicitly addressed in tenders.

CPR 10.6 (in Div 2) requires that

Request documentation must include a complete description of:

- ... d. evaluation criteria to be considered in assessing submissions and, if applicable to the evaluation, the relative importance of those criteria.

This applies to procurements of \$80,000 or more by non-corporate Commonwealth entities.

The CPRs don't help with working out what evaluation criteria for a procurement should be.

**We recommend that** the CPRs:

- (a) require the procuring agency, for all procurements above a relatively low threshold, formulate and publish the evaluation criteria for the procurement
- (b) provide guidance on the formulation of evaluation criteria, in particular, to ensure that the criteria will test the extent to which responses to approaches to market achieve the agency's procurement objectives.

## 8 Contract administration

### 8.1 Dealing with risk in contract management

There is a temptation, particularly in low to medium value procurements, for agencies to set and forget.

The CPRs note the importance of contract management to the achievement of overall value for money but do not make any provision in respect of ongoing contract management. The CPRs generally apply only up to contract award:

Procurement is the process of acquiring goods and services. It begins when a need has been identified and a decision has been made on the procurement requirement. Procurement continues through the processes of risk assessment, seeking and evaluating alternative solutions, and the awarding and reporting of a contract.<sup>17</sup>

At the very least **we recommend that** the CPRs be revised to require agencies to have well-developed contract management plans addressed to the requirements and risks of the individual procurements. These plans should identify the level of detailed agency involvement in the project, ensure that the agency has early warning of potential issues with contractor performance - it's no good waiting till the damage is done to deal with the problem - and ensure that the contractor remains focussed on performing the contract as intended. This is particularly important for procurements where design elements are significant, including in software development. In the design phase of a procurement, supervision and Commonwealth involvement is critical.

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<sup>17</sup> CPR 2.7.



The extent of management and supervision should be tailored to the significance, complexity and risks of the procurement.

## 9 Probity issues

The Auditor-General's reports identify conflict of interest issues and other probity issues.

### 9.1 Conflicts of interest

The CPRs do not address in any detail conflict of interest. They do not include a definition to help officials identify what may or should be regarded as a conflict.

Conflicts of interest will, and indeed, should arise in connection with procurements. If they do not, it means that relationships are so much at arm's length that there is a risk the Commonwealth does not understand the market, and it inherits other risks.

Conflicts of interest must however be managed. **We recommend that** the CPRs be amended to include a clear definition of conflicts of interest to guide officials, and provision about managing them in a way that is consistent with officials' obligations under the *Public Governance, Performance and Accountability Act 2013* and the *National Anti-Corruption Commission 2022*.

**We also recommend** that further centralised support be provided to assist agencies in identifying and appropriately managing conflicts of interest.

### 9.2 Other probity concerns

**We also recommend** that the CPRs be amended to respond to the increased emphasis on anti-corruption - including the ability to identify potentially corrupt activities and practices - within agencies and in interactions with suppliers and potential suppliers.

These amendments should also address the need for the Commonwealth to take steps to ensure that tenderers are complying with laws against anti-competitive behaviour, such as the prohibition on collusion between bidders. The ACCC has remarked that public servants and businesses may not be sufficiently aware of the risk of breaching cartel laws during the procurement process.<sup>18</sup> Particularly for technically complex procurements, and procurements where the Commonwealth wishes to encourage the formation of teams of suppliers to bid, guidance through the CPRs will be especially valuable.

## 10 Record-keeping and recording of the basis of procurement decisions

We agree with the conclusion of the Auditor-General in the reports as to the importance of record-keeping. Sound and consistent record-keeping practices are important, not just for transparency reasons (to demonstrate what was done and why) but also to support the Commonwealth's position in litigation and arbitration proceedings arising out of procurements.

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<sup>18</sup> ACCC "Warning on cartel conduct risk in public sector tenders" 1 November 2021 at <https://www.accc.gov.au/media-release/warning-on-cartel-conduct-risk-in-public-sector-tenders>.