

# **ADDITIONAL COMMENTS**

## **BY SENATORS JOHN MADIGAN AND NICK XENOPHON**

1.1 We welcome the Senate Finance and Public Administration References Committee Chair's report into Commonwealth procurement procedures.

1.2 We moved to have this inquiry because of the widespread disquiet from around Australia at how \$41 billion worth of Commonwealth procurement is conducted, with the many negative outcomes for Australian manufacturers that the procurement system produces.

1.3 The current state of play in respect of Commonwealth procurement is unacceptable and cannot be allowed to continue. There has been a lack of political will to-date to tackle this issue.

1.4 A key reform in Commonwealth procurement would be to consider the social and economic benefits, including the multiplier effects, of locally sourced procurement.

1.5 Just in this past week it has come to public attention that the Defence Materiel Organisation (DMO) rejected a tender for up to 100,000 pairs of work boots over five years from Rossi Boots of Adelaide. In the de-brief process the DMO were up front enough to tell Rossi executives that the decision was made on the basis of cost and awarded to an importer.

1.6 The Rossi case is emblematic of much of what is wrong with Commonwealth procurement and encapsulates much of the evidence heard by the Committee.

1.7 As Rossi Boots Chief Executive Neville Hayward told the media, all he wanted was a fair go, and it appears that the procurement system is almost designed to make Australian businesses and manufacturers disadvantaged in comparison to overseas suppliers.

1.8 Rossi's price was understood to be marginally higher than the winning tenderer, but not overly so.<sup>1</sup> But Rossi offered additional 'whole-of-life' benefits to the Commonwealth and to Australia due a range of factors, including durability, whole-of-life support, employment of Australians supporting Australian families and the economy, tax payments by the company and employees, compliance benefits of the company meeting Australian standards for employment conditions, the environment, OH&S and industrial relations.

1.9 We draw attention to Request for Tender DPS 13016 seeking manufacture and supply of Australian flags to be flown above Parliament House. We specifically draw attention to the long list of requirements Australian tenderers had to meet

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1 Defence Minister Johnston, 14 July 2014, *Senate Hansard*: "I am concerned that the amount of money involved is such that this...might well have gone to an Australian manufacturer."

covering adherence to such matters as the Racial Discrimination Act 1975, the Sex Discrimination Act 1984, the Disability Discrimination Act 1992, Part 4 of the Charter of the United Nations Act 1945 and list of other Acts. No such requirement is placed on tenderers applying from offshore.

1.10 This is frankly both absurd and unfair. The benefits to Australia of compliance with these requirements must be quantified within the procurement process so that Australian suppliers are not disadvantaged by simply following the law.

1.11 Any decision not to engage an Australian supplier should also take into consideration the opportunity costs by way of reduced employment in Australia, the resulting social welfare payments and burden on the community that unemployment causes.

1.12 While these costs and benefits are known and understood by many, both inside and outside government, they are not taken into active consideration by the Government in the procurement process.

1.13 It was clear from the evidence before the Committee that there is currently no practice of taking into account wider cost and benefit advantages of engaging Australian suppliers in procurement decisions.

1.14 Although whole-of-life costs were acknowledged by the Australian National Audit Office (ANAO) as an active consideration under the Commonwealth Procurement Rules (CPRs), the Committee asked if there was any “standardised way to assess value for money over the whole life of a procurement”. The ANAO representative could not provide one, saying:

Each procurement process would be different and would establish criteria before going out to the market to determine what is most important in the value-for-money considerations. But there are broad guidelines in the CPRs about what considerations need to be made.<sup>2</sup>

1.15 The CPRs address “non-financial costs and benefits” through the concept of “value for money” under CPR 4.5, and say that they may include, but not be 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)
- (d) Environmental sustainability (such as energy efficiency and environmental impact)
- (e) Whole-of-life costs

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2 Ms Tracey Martin, Senior Director, Australian National Audit Office, *Committee Hansard* 21 March 2014, p. 14.

1.16 Whole-of-life costs are currently ill-defined and should include the social and economic benefits of locally sourced procurement.

1.17 The Royal United Services Institute of the UK found in a 2012 report<sup>3</sup> found that over a third of defence procurement funds spent locally found its way back to the government in taxes. There should be an independent analysis of the extent to which government procurement funds spent locally are returned to the Commonwealth and states.

1.18 Among others witnesses, Australian Paper highlighted that, while the CPRs stated these wider factors should be considered alongside price, they were not being applied:

...the concept of value for money is being applied too narrowly within [FMA Act] Government agencies. As the CPRs state, value for money should encompass a range of considerations including environmental.<sup>4</sup>

1.19 The CPRs don't go anywhere near far enough in this area. As a result the Government pays 'lip service' to considering wider costs and benefits. That the CPRs merely provide an open ended list of possible factors that may, or may not, be taken into account, is unacceptable.

1.20 It is unsurprising that government agencies and departments do not take whole-of-life factors seriously, as they are not adequately spelt out nor a methodology set out as to how to quantify them. As a result, there appears to be no serious assessment of "through life" factors in procurement decisions.

1.21 We strongly support Recommendation 7 in the Committee's majority report:

**The committee recommends that the government develop a methodology to quantify the factors used to assess whole-of-life costs.**

1.22 However, that methodology should include the social and economic benefits of locally sourced procurement.

**RECOMMENDATION 1: That the Government urgently redraw the CPRs specifying a range of 'whole-of-life' factors that must be addressed in a procurement, including the social and economic benefits of locally sourced procurement.**

**RECOMMENDATION 2: That the Government, as an appendix to the CPRs, specify a methodology as to how a procurer must quantify or 'score' these 'whole-of-life' factors in procurement decisions and how they are to be assessed in comparison to quality and cost measures as part of the overall procurement decision.**

**RECOMMENDATION 3: That the Government consider the adoption or integration into the methodology from recommendation 2 a 'holistic, whole of**

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3 Trevor Taylor and John Louth, Royal United Services Institute, 20 January 2012: <https://www.rusi.org/news/ref:N4F194BF09B370/#.U7Sy6PnEJSh>

4 Australian Paper, *Submission 17*, p. 4.

**life, cost benefit analysis’. This form of analysis is used commonly in the mining, resources, energy and infrastructure sectors.**

1.23 We disagree strongly with the claim by the Department of Finance that 82.4 per cent of goods by value purchased by the Commonwealth Government are “likely” to have been sourced from “Australian suppliers, or in the case of services, delivered by Australian suppliers” because they had Australian Business Numbers (ABNs). In no way is this indicative of the country of origin of either products or services. An Australian ABN number is not indicative of country of manufacture.

**RECOMMENDATION 4: That the Department of Finance introduce a simple check with suppliers to track the true number and percentage of Australian suppliers to government.**

1.24 The Committee heard evidence from the Department of Finance, in response to claims that overseas suppliers are not held to the same standards as Australian suppliers:

It is inaccurate to say that overseas suppliers are not required to meet the same policies, regulations and standards as Australian manufacturers. Procurement contracts can only be awarded to suppliers who satisfy any relevant Commonwealth policies, including regulations. In prescribing standards, Commonwealth agencies must do this in a non-discriminatory manner and may use Australian standards. These requirements are captured in the Commonwealth Procurement Rules and reflect the Financial Management and Accountability Regulations 1997 that the spending of public money cannot be approved where it is inconsistent with Commonwealth policy. Hence, if an overseas supplier is not compliant with a particular standard as specified in tender documents, the agency is not required to award a contract.<sup>5</sup>

1.25 At the second public hearing, Mr John Sheridan, First Assistant Secretary, Technology and Procurement Division, Business, Procurement and Asset Management Group, Department of Finance, explained:

[A] procuring agency can apply the qualifications or the requirements that they might have for a particular procurement of any reasonable amount. So they might say not that you have to have an Australian certification because that may well discriminate against an overseas supplier, but it would be quite legitimate to say you should have an Australian certification or the equivalent or prove the equivalent. That would be reasonable in those circumstances and meet our Commonwealth procurement requirements and of course free trade agreement requirements.<sup>6</sup>

1.26 The comments by Finance officials make it clear that, as many witnesses to the inquiry said, Australian product standards are not, as a rule, applied to products considered for procurement from overseas.

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5 Department of Finance, answers to questions on notice, received 1 April 2014, p. 24.

6 *Committee Hansard*, 28 April 2014, p. 48

1.27 The comments also make clear that there appears to be either a knowledge gap with government procurement officials who may not be aware they have the power to apply Australian product standards to overseas suppliers, or simply a disregard of that power.

1.28 We support Recommendation 3 from the Committee's majority report:

**The committee recommends the Department of Finance provide education and training to agencies and their staff regarding the inclusion of Australian standards, or the equivalent, in tender documentation.**

**RECOMMENDATION 5: That the Government make it a rule that overseas suppliers must comply with Australian product standards without exception.**

1.29 The committee heard problems in relation to the Government accepting on face value the claims of quality, workplace safety, human rights and environmental standards, made by potential overseas suppliers.

1.30 For example, an Australia's Forest Products Association representative told the inquiry:

(The overseas supplier) are masquerading as 50 per cent recycled and presenting something else. It is just that 50 per cent recycled does not mean the same thing all over the world.... (but) that is as far as our departments are asked to look. That is the point. They have a list and they click on a box that says that it is 50 per cent recycled, they tick it and they move on and then they are into lowest price.<sup>7</sup>

**RECOMMENDATION 6: That potential overseas suppliers are required to bear a reverse onus of proof, making them responsible to prove to Australian procurement officials that the claims made about their product are correct.**

**RECOMMENDATION 7: That the Government apply a comprehensive and transparent system of efficacy testing and quality assurance to verify the claims made by overseas suppliers about their products' quality, environmental sustainability and fitness for purpose.**

1.31 We support recommendation 11 from the Committee's majority report:

**The committee recommends that, following consultation with stakeholders, the Department of Finance establish an independent and effective complaints mechanism for procurement processes.**

1.32 We support recommendation 12 from the Committee's majority report:

**The committee recommends that the government provide an explanation as to whether there are any reasons why the operation of the Competition and Consumer Act 2010 should not apply to Commonwealth procurement.**

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<sup>7</sup> *Committee Hansard*, 21 March 2014, p. 43.

1.33 University of Adelaide Associate Professor John Spoehr, also the Executive Director of the Australian Workplace Innovation and Social Research Centre (WISeR) is an expert in integrated economic, industry and urban research and practice.

1.34 Professor Spoehr believes Australia is among the worst performing developed countries in recognising and harnessing the benefits of government procurement for the local economy and wider community.

1.35 If Australia is to approach world's best practice Professor Spoehr believes, and we agree with him, that a longer term inquiry must be launched at the federal level by an appropriately qualified person to examine the challenges and opportunities at stake in this area.

1.36 The “Smart Procurement” agenda offers much for governments which, as this inquiry showed, have much room for improvement towards maximising Australian industry involvement.

1.37 Smart Procurement is a methodology which brings customer and supplier together in a longer term relationship which develops the solution to the procurement need over time, leading to a better informed customer (the government) and arriving at a much improved and cost effective outcome.

1.38 Smart Procurement also enables smaller firms to work together to provide procurement solutions on a scale that they would not otherwise be able to.

1.39 Together with the Committee’s majority report, I am deeply concerned at the discontinuation of the Enterprise Solutions Program (ESP), which improved access to government procurement by Australian small and medium sized enterprises (SMEs) and encourage government departments to actively consider Australian content for procurement.

1.40 A program similar to ESP, called Small Business Innovation Research (SBIR), is active in the United States and provides crucial early stage capital for local innovation – a market that is undeveloped in Australia – and the process results in government procurers becoming educated buyers.

1.41 Programs like ESP fit with the Smart Procurement agenda and are where Australian procurement needs to go. Unfortunately the Government has seen fit to end the program.

1.42 We support the Committee’s majority recommendation to ESP be recommenced.

**RECOMMENDATION 8: That the Government appoint an Australian Industry Participation Advocate, and an office to support him or her, to work with Australian businesses to better position them for bidding for procurement work and with governments to constantly revise procurement rules so as to maximise Australian involvement.**

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