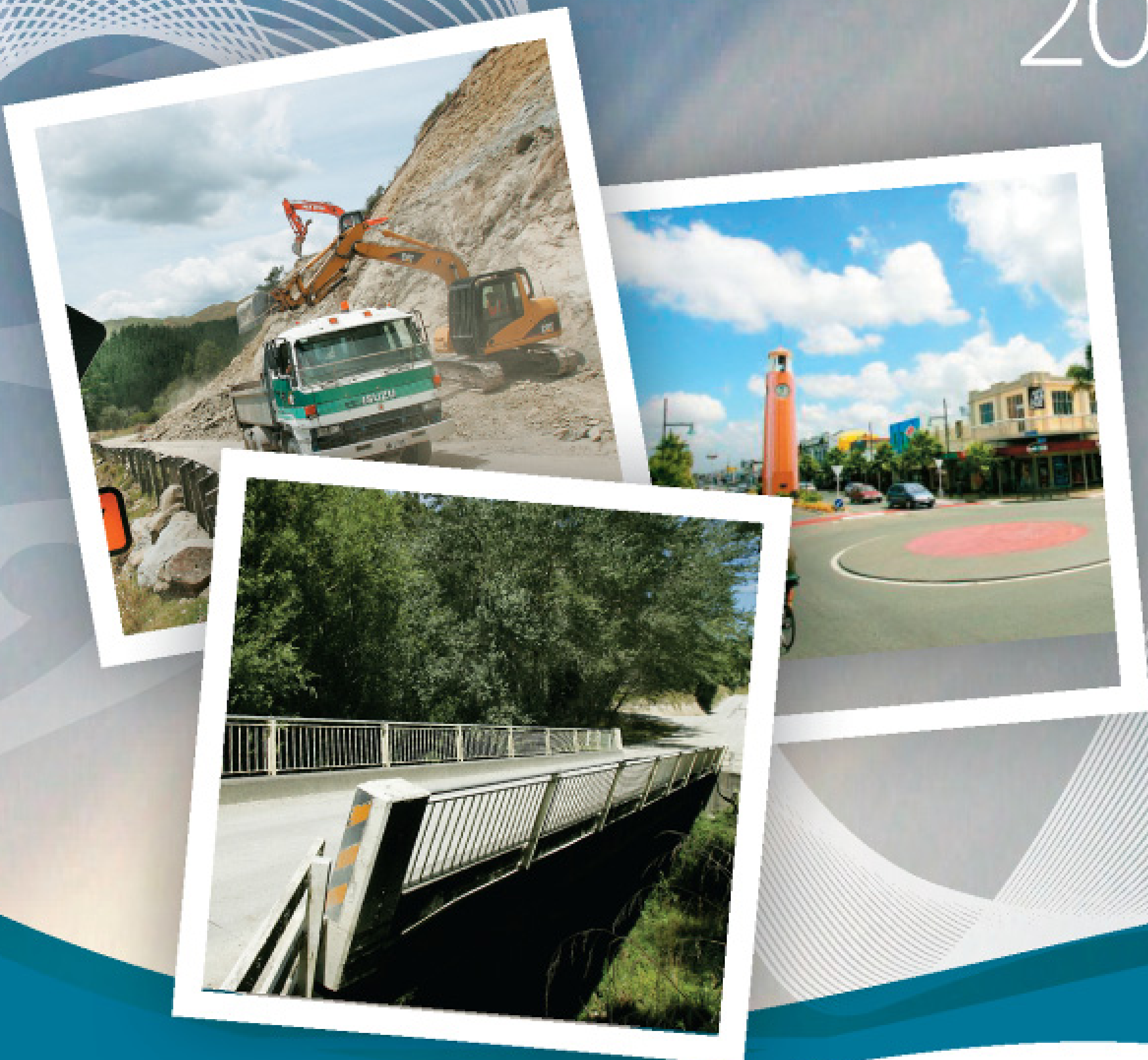
Procurement Manual 2011



GISBORNE
DISTRICT COUNCIL

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Procurement methods and processes

Background

The preferred procurement method and process will depend on the best option to obtain value for money. It will depend on the complexity as well as the risk of the cost of performance and delivery.

In general terms a contract exists where there is an offer (by those offering to supply the works, goods or services) and an acceptance of that offer by Council.

This can be as simple as the purchase of a pen and as complex as the delivery of a wastewater treatment plant. Both transactions are contracts, but the value and risks are quite different. Accordingly the form of contract, the terms, the documentation and the methods used in the procurement may be significantly different.

There are a number of accepted procurement methods available, but all need to take into account the principles of Council's Procurement Policy:

- Accountability
- Openness
- Value for money
- Lawfulness
- Fairness
- Integrity

In determining the most appropriate procurement method it is necessary to assess the value and risk of the purchase having regard to the nature of the works goods or services to be procured.

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

Figure 1 in **Procedure Guidelines** provides a matrix of the risk and value or purchases.

For **low value, low risk** purchases, the contract may be as simple as completing a purchase order or requesting goods and services with a procurement card.

For **medium value, low risk** purchases, a short form contract may be required.

For **higher value and higher risk** purchases, a more detailed contract will be required that reflects the risk and nature of the goods and services being procured.

For **higher value and higher risk** purchases it is expected the contract terms need to be appropriate and reflect:

- the nature of the works, goods or services
- any anticipated uncertainties in the supplier's ability to perform its contractual obligations; and
- the extent of any risk that the supplier will be required to assume.

Types of procurement methods

There are many types of procurement methods. These generally fall into two categories – Direct or Competitive processes (or a combination). The types of procurement may include:

- simple purchase by way of works or purchase orders
- simple purchase by way of petty cash
- procurement cards (eg petrol purchases)
- transactions with established suppliers (eg professional services)
- individual item purchases under a supply agreement (eg stationery)
- purchases from pre-selected suppliers (eg contractor pre-qualification)
- purchases following quotations from selected suppliers
- closed tenders from pre-determined suppliers
- open tenders
- staged tenders (open or closed)
- procurement following Registrations of Interest (RoI)
- procurement following Requests for Proposals (RfP).

Variations to these methods can include:

- design and build
- design build and operate
- alliancing
- public private partnerships.

Appendix 1 – Contract Types describes some of these contract types in more detail.

Some procurement options may be through a joint arrangement with other agencies. An example is the shared service arrangement with BOPLASS for some goods and services – eg insurance, stationery. Council also has a shared arrangement with many other Councils to provide cover for disaster insurance (LAPP). While there may be a combined approach with other agencies, it is important to note that the actual contract still remains with Council and the supplier.

All purchases are contracts, regardless of the procurement method used, and therefore the processes and appropriate documentation needs to be in place.

The procurement method and contract needs to reflect the relationship that Council wishes to establish with the supplier. Whether it is a simple purchase of a low value, low risk item or a high value, high risk purchase, or a desire for value and innovation. For example, as well as the more traditional "arm's length" contracts, partnering or alliances are increasingly being used.

Procurement planning

Individual procurement plans should usually be considered for **higher value and higher risk** procurement (Refer **Figure 1** of **Procurement Guideline**).

Procurement planning is necessary to identify:

- the best way to approach the procurement of goods or services (through information gathering and analysis
- risks associated with the procurement of goods or services early so that they can be managed
- ways of achieving the objectives defined for the procurement, in line with the Council's procurement policy.

A procurement plan should bring together the previous analysis and requirements in the planning process. The content and size of the procurement plan will vary depending on the value and risk of the procurement, and the size and resources of Council.

The amount of detail in the plan will depend on the value and associated risk of the procurement. The content should include:

- the project scope
- the procurement method and why chosen
- selecting an evaluation model (including the evaluation criteria) and process
- the type of contract and contractual conditions
- the responsibilities of Council's staff and any other stakeholders
- the risks
- the need for independent oversight or assurances over the process
- the timelines and key milestones
- the resources needed (for example, project manager, evaluation team members, tender or proposal manager and approving authority); and
- the budget, including the budget for conducting the procurement (for example, for external quality assurance, independent assurance, legal advice and project management).

Selection of procurement methods

Direct or selective procurement

Open competitive processes, for example inviting quotes, tenders or proposals from more than one supplier will not be applicable for all procurement by Council. In some instances, Council may procure directly from a supplier. In deciding to take this approach, Council will need to consider the value and risk of the purchase as well as the outcome that it intends from the procurement. In general, direct procurement should only be used for **low value, low risk** goods or services. (Refer **Figure 1**) and comply with Council's requirement for competitive procurement for goods and services valued greater than $50,000.

Council will consider purchasing directly from a supplier where:

- the value of the goods or services is very low
- the purchase of these goods or services is on an as-required basis
- it is not practical to aggregate separate orders for the goods or services; or

- the cost of seeking quotes or tenders would be out of proportion to the value of the benefits likely to be obtained or impractical in the circumstances.

There are other circumstances where Council would be justified in procuring from a selected supplier. Examples include where:

- the goods or services require specialised skills or are very complex
- there is a limited number of qualified suppliers
- the required goods or services are available from only one source
- only one supplier has the capacity to deliver within the time required
- standardisation or compatibility with existing equipment or services is necessary, and can be achieved through only one supplier.

Each decision to make a direct or selective procurement should be taken systematically by staff who have the necessary knowledge and experience of the procurement environment. When using direct or selective procurement, the decisions need to be supported by proper documentation. This should include demonstrating and recording:

- the reason for using direct or selective procurement
- why a particular supplier was identified
- confirm the supplier's capability to deliver the goods or services
- the supplier's performance against established criteria
- how the rates are reasonable and consistent with the market rates for items of a similar nature
- the method of payment
- the documentation to be retained for proof of procurement
- the requirements for authorising the procurement.

Emergency procurement

In an emergency, it may not be possible to satisfy the principle of open and effective competition throughout the procurement process. Council may therefore dispense with parts of the procurement process if it needs to react quickly to genuinely unforeseen events. The criteria for what constitutes an emergency include:

- life, property or equipment is immediately at risk
- standards of public health, welfare, or safety need to be re-established without delay, such as disaster relief.

It is noted that poor planning or lack of organisation in a procurement process does not justify using an emergency process.

Standing arrangements

Standing arrangements are procurement arrangements where Council is able to procure directly from suppliers for an agreed period of time. These can be both direct or established through open tendering. Council can set up these standing arrangements after a competitive process, or Council may wish to take advantage of competitive processes using by other entities (for example, by joining a syndicated procurement arrangement eg BOPLASS).

Entering into standing arrangements is a reasonable procurement strategy for the goods or services identified in quadrant 2 of **Figure 1** – goods or services that have high value but where the risk to the entity is low. These goods or services are generally widely used by Council. They have no special requirements, are simple to specify and have common standards. Examples of the types of goods or services that could be considered for these arrangements, depending on their value, include:

- fuel
- motor vehicles (eg through Government Stores Board)
- air travel; and
- stationery.

Competitive procurement process

Open tender or proposal processes are used to promote transparency and value for money. Open tender or proposal processes are most appropriate for middle to high value procurements where there are a number of potential suppliers in the market.

Depending on the value and risk or the procurement, competitive processes can involve verbal quotations, written quotations, or formal written tenders or proposals.

In principle, advertising an open request for tender or proposal should be the preferred method for higher value and/or higher risk procurement. It offers all interested suppliers fair and equitable opportunity, and allows a range of competing offers to be evaluated when assessing value for money. However, the method should be appropriate to the market for the particular goods or services, and the circumstances of the procurement. These considerations may mean that an open call for tenders or proposals is not practicable or cost-effective, or may not produce the best procurement outcome in some circumstances.

Although closed tender or proposal processes may be appropriate in some circumstances, the preference is for Council to make limited use of this procurement method. This is because using a closed tender or proposal method does not allow equal access to all suppliers in the market, which means that a better source of supply may be missed. When Council uses a closed tender or proposal process, it should document its reason for doing so. It should also properly document why using the closed tender or proposal method is justified.

The closed tender or proposal method should not be used to limit the number of potential tenders or proposals. If Council wishes to limit the number of tenders or proposals for procurement, it should use the multi-stage method. It is expected that Council, in deciding whether to use a multi-stage open tender or proposal process, should consider:

- the value and risk associated with the procurement
- the degree to which Council is able to specify the requirement
- whether Council is looking for innovative solutions; and
- the cost and resources required of both Council and the potential suppliers.

Council should consider using a multi-stage open tender or proposal process only where there are multiple potential suppliers or Council is unsure about the size of the market and the likely number of interested suppliers. In other situations, Council should carefully consider whether a single-stage open tender or proposal process is more appropriate.

A closed tender or proposal may be used for example, when:

- appropriate market research has identified that the goods or services are only available from a few suppliers
- Council can demonstrate that it is not practical or cost-effective to conduct an open tender or proposal
- there is genuine limited time for the procurement process and it is not limited because of poor contract management.

Council should also identify potential suppliers, for example:

- canvassing the market using a variety of sources of information; and
- making use of any past experience with any particular supplier.

When compiling a list of potential suppliers, Council should:

- take account of any applicable Council or Government policies (for example, "Buy Local", fair opportunity for regional, national or overseas suppliers. Council's **"Buy Local"** Policy is attached as **Appendix 2**.
- document the method used and keep adequate records to show that it has followed the method; and
- ensure that it has addressed any risks under the Commerce Act 1986 and other applicable legislation.

Guidance on the multi-stage tender or proposal method is given below including guidance on the circumstances when a multi-stage tender or proposal should be used.

Verbal quotations

Verbal quotations provide a quick and convenient way of exploring the market and determining availability and price for low value, low risk goods or services.

Using quotations will not change the requirement for good procurement practices. The procurement objective is still to achieve value for money (that is, a combination of quality, reliability, timelines, service and whole-of-life cost).

The value and risk of the procurement and the number of potential suppliers should determine the number of quotations sought. Generally this should be **no less than three**. Records of decisions, including reasons for recommending and deciding on the selection and rejection of offers, should be kept in a manner that facilitates audit and other normal processes of accountability.

If staff are only getting quotations, they need to be careful when talking to suppliers to avoid inadvertently making a verbal promise to purchase from the supplier.

Written quotations

The expectations are the same as those required for verbal quotations (see above).

However as the value and risk of these goods or services is likely to be higher, the process and documentation should be more comprehensive. However, the process and details recorded should still depend on the value and risk of the goods or services. The value and risk of the procurement and the number of potential suppliers should determine the number of quotations sought. Generally this should be **no less than three**.

The process that should be followed when requesting written quotations should address the following:

- definition of the need
- a clear understanding of the goods or services to be procured
- specification
- establishing the potential sources of supply
- appropriate approval for the procurement
- seeking written quotations
- evaluation of responses
- selection of a supplier
- approval for the decision
- advising the decision – both to the successful and unsuccessful participants
- monitoring performance of the service provider

The evaluation process should provide a fair comparison between the responses. The same evaluation method should be applied to each response. The selected quotation should provide the best value for money when assessed against the evaluation criteria. When the responses have been assessed and a supplier selected, a short report should be produced outlining the findings of the evaluation process including the recommendation and reasons for the recommendation (especially if the supplier offering the lowest price is not recommended). For smaller, less complex procurement, the reasons for the selection may be noted on the relevant procurement documents (eg on the works order).

The recommendation to accept a quotation should be approved by a staff member with the appropriate delegation. The staff member should satisfy themselves that the best offer, as measured against the evaluation criteria, is being accepted.

Competitive tenders or proposals

There are a number of terms used that relate to the process of inviting tenders or proposals from the market:

- A **registration of interest (ROI)** or **expression of interest (EOI)** is generally used to request information from suppliers that may be used to identify potential suppliers before seeking tenders or proposals. Usually the information sought is high level and specific to the procurement.

- A **request for proposal (RFP)** is a formal means of seeking proposals for goods or services where Council is open to innovation on the part of a supplier, that is, where the outputs and outcomes are important, not the process the supplier follows to deliver them. The RFP therefore normally invites suppliers to make a proposal based on specifications, with scope for variety and innovation. This method is usually used to seek a solution to a problem or process, or where there is a range of options.
- A **request for tender (RFT)** is a formal means of seeking tenders to provide goods or services. It is used where Council's specification or requirements are clearly defined and there is little room for flexibility or innovation. An RFT is often based on technical, highly prescribed specifications. This method is often used in the construction industry.

In complex procurement activities where Council needs to lean more about the goods or services or the market, it may be helpful to use a multi-stage process:

- Stage 1: An ROI or EOI is issued to find out more about the goods or services, the market and the capability of suppliers to satisfy the procurement need.
- Stage 2: An RFP or RFT is issued requesting suppliers to submit an offer for goods or services or propose a solution.
- Stage 3: The tenders or proposals received at Stage 2 are evaluated and a contract is awarded to the preferred supplier.

In addition, Council may include another stage between Stages 2 and 3 where Council invites the most promising of the suppliers from Stage 2 to submit their final bid.

Multi-stage processes are time consuming and expensive for all parties. They should only be used for goods or services categorised as high value and high risk. In these circumstances, a multi-stage process may reduce tendering costs.

Closed and open tenders

The method of inviting tenders or proposals may be "open" (all possible suppliers are invited to respond) or "closed" (only some of the possible suppliers are invited to respond). A closed tender or proposal involves inviting a predetermined list of suppliers to respond without an open pre-selection or prequalification process as part of a multi-stage process.

The section below entitled **Management and Evaluation of Procurement Processes** sets out expectations and recommended guidance on conducting a tender or proposal process.

Registered or qualified supplier lists

A variation on the open or closed tender or proposal process is pre-qualification using registered or qualified supplier lists. Pre-qualification is a method where Council assesses suppliers or particular goods and/or services against predetermined criteria to respond. Council generally includes suppliers that are successful in meeting the pre-qualification criteria on a database it maintains.

Pre-qualification in itself does not form a contractual or legal relationship between Council and the pre-qualified supplier. Essentially, the supplier has simply met preliminary standard criteria and will be required to meet other evaluation and performance criteria as part of a procurement process.

Pre-qualification differs from multi-staged procurement and panel contracts (see next section) in that there is no specific contract in mind when suppliers are pre-qualified. Although there is the potential for pre-qualified suppliers to win tenders or proposals over time, pre-qualified suppliers are not necessarily given any guarantee of work. Pre-qualification should not normally be used to get price information from suppliers.

The need for a pre-qualification should be considered carefully. For example, pre-qualification adds no value and is not an appropriate procurement strategy when procuring off-the-shelf goods or services where there are several sources of supply and the value is low.

The process that should be followed when compiling registered or pre-qualification lists should address the following:

- definition of the need
- a clear understanding of the goods or services to be procured
- specification
- the information that is required from potential suppliers
- the method that will be used to evaluate registered or qualified suppliers for inclusion on the list
- who will approve a supplier's inclusion on the list
- the way the list will be maintained
- the way suppliers will be notified of the results; and
- the documentation and records of the process and the results of the process.

Panel contracts

A panel contract (or panel arrangement or standing offer) is a contractual arrangement with a group of suppliers to provide services as and when required, under a schedule of rates for each supplier or based on a quotation.

Panel contracts are appropriate where:

- fixed prices, fees, or rates can be agreed with each supplier
- the "demand" or requirement for goods or services cannot be predicted
- the goods or services do not all need to be provided by the same supplier
- there are specific requirements, such as specialised skills and knowledge
- allowing for greater choice of supplier is seen as an advantage or provides a contingency in case an alternative supplier is required because a conflict of interest arises with a preferred supplier
- goods or services may need to be procured at short notice
- Council may need a variety of skills at different stages; and
- It cannot be predicted that one supplier could provide the goods or services at any point in time, for example, the work cannot be handled by one particular supplier alone.

The method is commonly used for the supply of professional services, such as engineering, legal, IT, financial and accounting advice and specialist consultancy services.

Panel contracts should be set up through a competitive process. The method of how the work will be divided between the panel members should be determined before potential suppliers are invited to participate in the competitive process. The potential suppliers should be made aware of the method, and the methods should be followed.

There needs to be provision that enables Council to review membership of the panel and remove panel members if required. The contract should specify grounds for terminating a supplier's membership of the panel.

The process that should be followed when compiling a contract panel should address the following:

- definition of the need
- A clear understanding of the goods or services to be procured
- specification
- the information that is required from potential suppliers
- what will be required of suppliers in terms of service levels, response times and other performance measures
- how Council will allocate the work to panel members, for example:
  - **Hierarchical:** One panel member receives most of the work unless they are unable to supply the public entity's needs or have a conflict of interest. In this case, the work is allocated to the next available panel member.
  - **Equal division of work:** This can be handled by an upper limit arrangement, where the next supplier is chosen once a specified dollar limit is reached by one supplier.
  - **Rotational basis:** Work is distributed to each panel member in turn regardless of value or time.
  - **Reliability and expertise:** Work is allocated to the panel member who is most suitable and available.
- the method that will be used to evaluate suppliers for inclusion on the panel
- how Council will engage panel members to do particular work
- circumstances that may lead to a supplier being removed from a panel
- who will approve a supplier's inclusion on the panel
- the way the panel will be maintained
- the way suppliers will be notified of the results; and
- the documentation and records of the process and the results of the process.

The types of method of engagement and the circumstances where each applies should also be provided: For example:

- **Standing offer arrangements** are usually used for services as required. This is often on the basis of a tender or proposal, quotation, or other arrangement (for example, a fixed fee arrangement). Generally, the "offer" has a limited timeframe after which it would lapse and a new set of fees or arrangements would be negotiated.
- **Period contracts** involve an individual contract with each panel member for a fixed period of time. Generally, period contracts incorporate other more complex elements than time (eg resources).
- **Retainers** are generally used for professional advisory or consultancy services. The panel member is paid a prescribed fee to ensure access to defined services or t a defined amount of services, for a period when required. This is probably the least common arrangement because it involves a forward payment for services that may or may not be used.

Relational purchases

Relational purchase categories for procurement recognise situations where a contract may not fit the conventional market model because:

- there is not an effective or meaningful market to provide the goods or services; or
- the strategic importance of the goods or services, or of the relationship with the provider, is such that the objectives of the procurement may not be achieved through the market.

These two factors may be more often present for Council when it purchases goods or services that are essential to the delivery of Council (and implicitly non-market) services, are highly specialised, or are provided by non-commercial and public interest bodies such as non-governmental organisations.

Other factors that might suggest a relational purchase include the nature of the goods or services purchased, the duration of the relationship between the parties, the relationship between Council or external party and an end user (such as a person receiving healthcare or other social services), and the specialist nature of the goods or services.

For some external parties, there may be other policy goals that are relevant and would suggest a relational approach, such as a goal to support the development of a strong and stable non-government organisation or civil sector, or a goal to develop strategic relationships or build capacity in some part of the wider sector.

In such situations, conventional market-based systems for managing a contract may not be appropriate or particularly effective. It may be more useful to given greater weight to the relationship or strategic dimensions of the contract and to develop other systems to manage the dimensions usually managed by competitive market mechanisms.

Common examples of minor relational purchases include contracts to purchase policy or other advice from specialist advocacy or special interest representative groups, highly specialised professional advice, small and specialised research work, or the supply of minor health services or a niche product for a particular and unusual requirement.

Common examples of major relational purchases include residential care or other social support services where the funding arrangement may need to provide stability for end users over many years, major and long term research contracts, or significant professional or consultancy relationships.

Partnering and project alliances

There can be some overlap between major conventional contracts (where an effective market is present and used) and major relational purchases. The growing pattern of managing major contracts through more strategic arrangements, such as alliancing and public private partnerships, has a lot in common with major relational purchases, even if they are developed in the market context.

Partnering and project alliances between public and private sector organisations are gaining in popularity as an approach to procuring major infrastructure projects and related services in the public sector. Partnering refers to mutually beneficial commercial procurement relationships between public and private sector parties that involve a collaborative approach to achieving public sector outcomes. The two main variables in a partnering arrangement are:

- the type of the relationship between the public and private sector parties; and
- the nature of the outcome and how it is to be achieved.

In a project alliance, the public and private sector parties (often referred to a "participants") work together as an integrated team to deliver a specific project where their commercial interests are aligned with actual project outcomes. The team is selected on a "best-for-project" basis and is provided with incentives to achieve high performance. All members commit to working through collaboration, innovation and mutual support. This arrangement requires:

- performance obligations to be stated as collective rather than individual
- obligations, with an equitable sharing of risk and reward, and adoption of a "no blame, no dispute" culture
- governance of the project by the project alliance board (or equivalent)
- including representatives from all parties, with agreement that all decisions must be unanimous
- day-to-day management of the project by a project team that operates as a separate entity from each of the public and private sector parties involved in the alliance agreement; and
- a transparent and "open book" approach towards all financial matters, including cost and profit.

However there is a need to ensure that the arrangement does not result in aberrant behaviour in that the overall outcome4 is not achieved eg a single focus may produce the specific work but wider issues are missed or the levels of service are not met.

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 goods or services and provides the best value for money. Tender or proposal evaluation models help in deciding which potential supplier this is.

Evaluation models are not a science but rather tools to support the evaluation team in making their decisions. Ultimately, the evaluation team is responsible for deciding which option provides the best value for money. However, the chosen tender or proposal evaluation model should provide a rationale to support the evaluation team's decision. It should be decided at the procurement planning stage how the tender or proposal will be evaluated. Depending on the value and risk associated with the procurement, it may require an evaluation plan. In any case, Council should select and document an evaluation model at the procurement planning stage, and also document the reason why it chose that particular model.

The evaluation model should be set out in the procurement documents so that suppliers know how the tender or proposal will be evaluated. The evaluation criteria should be detailed enough to enable the Council to assess the relative strengths and weaknesses of each respondent.

Types of evaluation models

There are a number of tender evaluation models available that may be used for different circumstances. For example, the three most commonly used models are the lowest-price conforming model, the weighted-attribute model and target-price model. The Books' Law model is also used in evaluating proposals for professional services for building and roading contracts.

The **lowest price conforming** model is the most basic model, and has the strongest emphasis on price. With this model, the lowest priced tender or proposal is selected once a prerequisite level of quality is met. It is applicable where additional quality over and above a minimum threshold is not important (that is, it does not offer greater value for money).

The **weighted attribute model** is the most common model used in public sector procurement. This model seeks to balance the trade-off between price and quality, and it can be used for goods or services. Under this model, the criteria are weighted to reflect their relative importance. Each criterion in the tender or proposal is scored, and each is multiplied by the relevant weighting to give a weighted score. The weighted scores for each tender or proposal are added up to find the highest scoring tender or proposal. Some weighted-attribute models weight all the evaluation criteria, including price, while others only weight the non-price criteria. If weighting price, it is important to carry out some level of sensitivity analysis as part of the weighting process to ensure that the price weighting is appropriate. For example, if the price weighting is too high, the evaluation effectively becomes a lowest-price conforming model.

The **target-price model** is useful when it is difficult to define the scope of the work in the tender documentation or in situations where the budget that is available is the main constraint. In such instances, Council would be likely to receive a range of tenders or proposals and prices that are not easily compared, and that may exceed the available budget. The solution is for Council to make the potential suppliers aware of the available budget (the "target price") as a guide for defining the scope of the services desired, and then inviting potential suppliers to specify what they can do for that price. The focus of the evaluation is then on the quality and quantity of the services to be provided rather than price.

The **Brooks' Law model** assesses proposals on the basis of technical merit. The highest ranked supplier is invited to discuss the proposal, contract, terms and fees. The terms of reference and the contractual and legal requirements are reviewed to ensure a mutual understanding. When agreement on fees is reached, the supplier is appointed. If no agreement on fees is reached, the second ranked potential supplier is invited to negotiate. The process continues until a satisfactory agreement is negotiated. A supplier, once rejected, should not be recalled for further negotiations.

Conducting a tender or proposal process

In conducting a tender or request for proposal process Council should seek appropriate information during the fist stage, for example:

- the potential supplier's contact details
- the potential supplier's qualifications and experience
- in the case of services, the potential supplier's capacity to meet the public
- entity's specified requirements; and
- in the case of goods, what the potential supplier is able to provide.

Council should also specify how the evaluation panel (or tender evaluation team) will be appointed. It should also set out the process the panel will use to evaluate the tenders or proposals.

To ensure that it asks the right questions, Council should develop and agree the evaluation criteria before it invites potential suppliers to participate.

The evaluation criteria should normally consist of:

- compliance check or mandatory criteria (scored as a pass/fail or yes/no; and
- non-mandatory criteria (which are normally scored on a 0-5 or 0-10 scale) that compliant tenders or proposals are fully evaluated against.

Compliance checks or mandatory criteria should, as a matter of good practice, be highlighted as part of the first stage specification to ensure that potential suppliers who are not able to meet these requirements do not waste their time submitting a response.

Council should draw up a shortlist by scoring each response against the criteria. It should also record enough information to keep a full record of the pre-qualification process, and to demonstrate that each response received due consideration.

It should also set out the process for advising shortlisted suppliers that they have been shortlisted and for notifying unsuccessful suppliers that they have not been shortlisted. Unsuccessful suppliers should be offered an opportunity to be debriefed on the reasons they were not shortlisted. The offer of a debriefing should set out the scope and likely format, and should make it clear that the process will not be used to change the selection decision or reopen the process.

Post-evaluation negotiation is an effective risk management tool. From the Council's perspective, the primary objective of the negotiations should be to:

- test the understandings and underlying assumptions that have influenced a participant in preparing the costs; and
- achieve a reduction in costs, where appropriate.

During post-evaluation negotiations, Council will ensure that:

- it conducts all negotiations ethically, and does not use its position in a manner that might be considered unfair.

Council may need to seek guarantees if the participant has limited assets or cash flows, particularly where a participant submits a comparatively low price.

If negotiations are to be conducted, Council should prepare a negotiation plan. The tender or proposal documents should advise participants of the possibility of post-evaluation negotiations and may identify the parts of the tender or proposal that may be negotiated.

As a general rule, Council should negotiate first with the highest ranked participant. If the outcome is unsatisfactory, it will then negotiate with the next highest ranked participant, and so on down the list until a satisfactory outcome is achieved.

Concurrent negotiations may be required in limited circumstances. Concurrent negotiations must be approached with care to ensure that they remain fair. Playing one participant off against another (that is a "Dutch auction") should be avoided.

By the end of negotiations, each party should have the same expectations about its obligations and how the contract will operate. The parties should agree on all substantive issues that might have an effect on price and monitoring of the successful participant's performance, before the contract is signed.

Approving the preferred participant and awarding the contract

A clear recommendation on who the preferred participant is must be provided to the authority (delegated staff or Council) approving the award of the contract. It should provide enough information to allow the approving authority to understand the evaluation process and the rationale for the recommendation. The amount of detail given to the approving authority should be in line with the value and risk associated with the procurement. The approving authority should be able to make an informed judgement on the adequacy of the tender or proposal process and the validity of the tender or proposal selection.

The recommendation of the preferred participant should reflect the outcome of the evaluation process.

If the approving authority rejects the recommendation, it should:

- clearly document the reason for not accepting the recommendation; and
- ensure that the reason is legitimate (this would usually be the result of an unforeseen event that was not identifiable earlier in the process).

The awarding of the contract may be carried out by those with delegated authority (including Committees of Council) or by Council resolution. The successful participant will be formally notified and the contract signed.

Managing Contracts

Contracts can be arranged in a variety of ways. For example, they may be negotiated between Council and the provider as part of a relational contractual situation, negotiated with a preferred supplied as part of a direct or selective procurement, or the result of a competitive tender or proposal process.

Regardless of how the contract or agreement is arranged and whether it is a conventional or relational contract, Council is responsible for the ongoing management of:

- the contract; and
- the relationship with the supplier of the goods or services.

Council needs to monitor and manage the supplier's performance to assess whether Council is receiving value for money. It should determine the extent of the managing and monitoring based on risk management and cost/benefit assessments.

Monitoring and managing supplier performance should be a priority when the value and the risks associated with the procurement are high.

APPENDIX 1: Contract Types

Alliance contract

An alliance is a long term commitment between two or more entities for the purpose of achieving clearly stated business objectives by maximizing the effectiveness of each participant's skills and resources, leading to an "alliance contract".

Alliances are collaborative arrangements where parties jointly work together to deliver the outcomes of a project. They are characterised by risk sharing and a no-disputes/no-blame regime. Since alliances are typically used for high risk projects with high levels of uncertainty, alliances are rarely used for building construction.

An alliance is an agreement between two or more entities, which undertake to work cooperatively, on the basis of a sharing of project risk and reward, for achieving agreed outcomes based on principles of good faith and trust and an open-book approach towards costs.

The common features of an alliance are:

- Risk is shared between customer and supplier;
- The alliance contract typically contains a 'no-disputes clause' with no liability between participants (except for wilful default);
- The customer and supplier share common goals for project success;
- All transactions are of an 'open book format', and
- All participants win, or all participants lose, depending on the outcomes actually achieved (incentivised cost reimbursement).

Benefits of alliancing

The collaborative nature of the alliances, coupled with risk sharing and a regime of 'no disputes' introduces substantial benefits when compared to conventional contracting options. The main benefits of alliancing include:

- Creation of a commercial framework which aligns the interests of all parties;
- Improved risk management especially with uncertain project requirements and environments;
- Earlier involvement in preliminary design activities providing greater visibility of project costs and improved decision making outcomes;
- Reductions in resources needed to administer contracts, especially contract change proposals;
- Improved project performance and innovation; and
- Greater transparency in project prices.

Disadvantages of alliancing

Despite the potential benefits afforded by alliances and the reported successful track record in the use of such contracts, there are a number of disadvantages in the use of these contracting mechanisms compared to conventional contracts. Some of these include:

- fewer legal remedies should the project go awry;
- acceptance by a Principal of risks that may be broader than the risks normally associated with a conventional contract;
- less emphasis on price competition
- the need for greater involvement of management resources in the alliance;
- no cap on the project schedule or cost;
- an increased risk of opportunistic behaviour;
- increased risk of decision making deadlocks;
- potential for very large lead time to establish the alliance (especially for procurement agencies that do not regularly use alliancing),
- relatively high tendering costs, and
- potential for a mismatch in negotiating skills between the private sector and public participants.

Cost plus contract

A contract agreement wherein the purchaser agrees to pay the cost of all labor and materials plus an amount for contractor overhead and profit (usually as a percentage of the labor and material cost). The contracts may be specified as

- Cost + Fixed Percentage Contract
- Cost + Fixed Fee Contract
- Cost + Fixed Fee with Guaranteed Maximum Price Contract
- Cost + Fixed Fee with Bonus Contract
- Cost + Fixed Fee with Guaranteed Maximum Price and Bonus Contract
- Cost + Fixed Fee with Agreement for Sharing Any Cost Savings Contract

This types of contracts are favoured where the scope of the work is indeterminate or highly uncertain and the kinds of labour, material and equipment needed are also uncertain. Under this arrangement complete records of all time and materials spent by the contractor on the work must be maintained.

Cost + fixed percentage contract

Compensation is based on a percentage of the cost.

Cost + fixed fee contract

Compensation is based on a fixed sum independent the final project cost. The customer agrees to reimburse the contractor's actual costs, regardless of amount, and in addition pay a negotiated fee independent of the amount of the actual costs.

Cost + fixed fee with guaranteed maximum price contract

Compensation is based on a fixed sum of money. The total project cost will not exceed an agreed upper limit.

Cost + fixed fee with bonus contract

Compensation is based on a fixed sum of money. A bonus is given if the project finish below budget, ahead of schedule etc.

Cost + fixed fee with guaranteed maximum price and bonus contract

Compensation is based on a fixed sum of money. The total project cost will not exceed an agreed upper limit and a bonus is given if the project is finished below budget, ahead of schedule etc.

Cost + fixed fee with agreement for sharing any cost savings contract

Compensation is based on a fixed sum of money. Any cost savings are shared with the buyer and the contractor.

Design and build contracts

Design and Build is a project delivery system in which the design and construction services are contracted by a single entity. The traditional approach for construction projects consists of the appointment of a designer on one side, and the appointment of a contractor on the other side. The design and build procurement route changes the traditional sequence of work. It provides for a single-point of responsibility in an attempt to reduce risks and overall costs. Design and Build, with its single point responsibility, carries the clearest contractual remedies for the clients because the contractor will be responsible for all of the work on the project, regardless of the nature of the fault.

However, design and build may not be appropriate where the facility to be delivered is complex or specialised in that there needs to be a high level of specification by the owner. This is specifically so where there are few contractors experienced in the type of work proposed.

Advantages

- where appropriate design-build can save time and money for the owner,
- the construction team is motivated to work with the design team to develop a design with constructability in mind.
- provides the opportunity to achieve innovation in the delivered facility

- In that way it is possible for the team to creatively find ways to reduce construction costs without reducing the function of the final product.
- owner can expect a reduced price due to the increased constructability of the design.
- By letting out the contract as a design-build contract, the contractor is established, and early mobilization and construction activities are able to proceed concurrently with the design. Under a traditional contract, construction cannot begin until after the design is finished, the project is bid and awarded, and the team can mobilize.
- Allows owners to avoid being placed directly between the architect/engineer and the contractor.
- places the responsibility for design errors and omissions on the design–builder, relieving the owner of major legal and managerial responsibilities.
- The burden for these costs and associated risks are transferred to the design–build team.
- The cost and schedule reduction and decreased litigation associated with design–build project delivery have been demonstrated repeatedly

Disadvantages

- Design–build does not make use of competitive bidding where prospective builders bid on the same design.
- Criteria to select contractor is subjective and difficult to evaluate and to justify later and therefore, the design and price selected can arouse public suspicion, true or not.
- It is difficult to evaluate the more complex the proposal is
- limits the clients' involvements in the design
- contractors can make design decisions outside their area of expertise
- There is the inherent conflict of interest. In a standard contract the designer is responsible to the owner to review the work of the builder to be sure the products and methods meet specifications and codes.
- design flaws may go unnoticed or unmentioned when the builder is also the designer.
- The owner may be more likely to get a building that is over-designed in order to increase costs and profits for the design-builder, or built with lesser grade products to maximize profits.
- a designer—rather than a construction professional—is a better advocate for the client or project owner and/or that by representing different perspectives and remaining in their separate spheres, designers and builders ultimately create better buildings.

Incentive contracts

Compensation is based on the engineering and/or contracting performance according an agreed target - budget, schedule and/or quality.

The two basic categories of incentive contracts are

- Fixed Price Incentive Contracts
- Cost Reimbursement Incentive Contracts

Fixed Price Incentive Contracts are preferred when contract costs and performance requirements are reasonably certain.

Cost Reimbursement Contract provides the initially negotiated fee to be adjusted later by a formula based on the relationship of total allowable costs to total target costs. This type of contract specifies a target cost, a target fee, minimum and maximum fees, and a fee adjustment formula. After project performance, the fee payable to the contractor is determined in accordance with the formula.

Lump sum contract

With this kind of contract the engineer and/or contractor agrees to do the a described and specified project for a fixed price. Also named "Fixed Fee Contract". Often used in engineering contracts.

A Fixed Fee or Lump Sum Contract is suitable if the scope and schedule of the project are sufficiently defined to allow the consulting engineer to estimate project costs.

Percentage of construction fee contracts

Common for engineering contracts. Compensation is based on a percentage of the construction costs.

Performance based contract

In a performance-based contract, the fee paid to the contractor depends (at least partly) on the business results achieved within the contracted work. This means that apart from the quality, speed, etc, of the work itself, the results of positive and negative work achievements is shared. For example, in the case of maintenance contracts, the mutual goal may be reduced mechanical equipment downtime (increased uptime). The benefits are long-term relationship and confidence building, reduced amount of contractors, mutual goals, and sharing the risks of unknown events. Overall cost reductions are mentioned from 9% to 30%.

Procurement cards

Using procurement cards can be an efficient way to procure low value and low risk goods and services, because cardholders can purchase directly from a supplier, which reduces costs. They do not have to fill in purchase request forms that have to be processed by purchasing staff. Cardholders can order and receive items much more quickly. This reduces the need for large inventory holdings. Less time spent checking and authorising purchases improves efficiency. The price of the item is charged to the card. At the end of an agreed period, Council will receive a statement listing the purchases so that they can be verified. The card company sends a consolidated invoice to Council, which is settled in one payment.

Unit price contract

This kind of contract is based on estimated quantities of items included in the project and their unit prices. The final price of the project is dependent on the quantities needed to carry out the work.

In general this contract is only suitable for construction and supplier projects where the different types of items, but not their numbers, can be accurately identified in the contract documents.

It is not unusual to combine a Unit Price Contract for parts of the project with a Lump Sum Contract or other types of contracts.

Works or purchase order

A commercial document issued by a buyer to a seller, indicating types, quantities, and agreed prices for products or services the seller will provide to the buyer. Sending a purchase order to a supplier constitutes a legal offer to buy products or services. Acceptance of a purchase order by a seller usually forms a one-off contract between the buyer and seller, so no contract exists until the purchase order is accepted.

APPENDIX 2: Buying Local

10/201

Subject: **Procurement Policy – "Buying Local"**

Prepared by: Peter Higgs (Engineering and Works Manager)

Meeting Date: 8 April 2010

Report to OPERATIONS Committee for decision

SUMMARY

This report proposes a change to the Procurement Policy that would enable Council to give a preference to a local business/supplier when quality/attributes/price of tenders are otherwise similar to recognise a contribution to the local economy.

RECOMMENDATIONS

That the Committee

1. **receives the report**
2. **Recommends that Council amend the Procurement Policy to include a section on "Buying Local" that states:**

   "Where attributes and prices are similar between businesses/suppliers, Council will give preference to local businesses/suppliers within a margin of 1% of the best price offered."

   (This policy does not apply where the procurement involves NZTA funding).

Peter Higgs
Engineering and Works Manager

1. BACKGROUND

The Chairman of the Operations Committee requested that a paper be prepared to facilitate discussion on possible changes to Council's procurement policy. The proposal would enable Council to consider a margin or weighting in favour of local businesses/ suppliers which provide goods and services to Council that recognises benefits to the local economy.

At a deliberative meeting on 11 March 2010 there was general support to investigate possible options to deliver this.

2. DISCUSSION

Council is the largest consistent procurer of goods and services in the district. While there may be other organisations that from time to spend more, these are usually one-off capital works.

Procurement is about how Council obtains goods and services. Council has a procurement policy. This policy primarily addresses the process, the methods of procurement and levels of delegation.

Procurement normally focuses on achieving the "best value" or "value for money" which includes the whole of life cost and quality.

Public spending strategies can deliver the goods and services a community needs plus achieve other aims such as economic and community development for the same or less money. Public spending can produce a wider public benefit.

Local economic development can benefit from the Council's procurement policy, in two ways:

- local solutions to public service delivery keeps money circulating in the local economy, plus
- developing local solutions raises capacity and expertise of local people and businesses.

What is a local area?

A local area can be different to different people - from a neighbourhood, to town, to regional to national.

Obviously, the narrower an area is defined, the harder it becomes to obtain the variety of services and competition. But the larger the area, then the variety of services and ability to deliver can increase.

What is a local business/supplier?

Again a local supplier can be different things to different people.

For example, a "national" business that employs 100 local residents and spends $10m per year on local services and subcontractors, contributes a significant amount to the local economy.

However, a business that has a "local" registered office but subcontracts all the work to others outside the area may contribute only a minor amount to the local economy.

Rather than try to define "what is local", it would be better to evaluate how the business/supplier contributes to the local economy relative to others.

A key contributor to the local economy is the extent to which the business/supplier provides employment to local residents. These people will in turn spend their wages on other local goods and services, and so on – the local multiplier effect.

A business that predominantly produces locally, employs locally, uses local industries and obtains other local goods and services (e.g. horticulture, food production, wineries, the farmers' market) would generally have a much higher impact on the local economy than say a business that imported products to the area and added little extra value.

That is not to say that isolation or trade protection should be promoted. We need trade at all levels, we also need to export.

Also it is not to say that a service that is over-priced should be accepted just because it is local. After all, we should be achieving value for money for the community. A much more expensive service will cost the users/ratepayers and could have a negative impact on the local economy.

But what it does suggest is that if two businesses/suppliers had the same attributes or quality of products and similar price, then there is a benefit to the wider community in utilising the services of the one that contributes more to the local economy.

In assessing the contribution of businesses to the local economy, Council should take into account the extent to which they:

- provide local employment
- use local suppliers/subcontractors/services
- manufacture/produce locally
- add value locally
- build local capacity - train and develop locals
- contribute to local community (cash or kind)
- look for local innovative solutions
- provide local resources during emergencies

What margin should be applied to "local businesses"?

In many cases local businesses should have an advantage in that they have local knowledge, local staff and suppliers. They do not have to provide accommodation for their staff if the work/service is a contract.

However, an out-of-towner may be able to bring economies of scale.

The benefit to the local economy by buying locally can be assessed using the local multiplier effect. However, the benefit will vary significantly depending on the type of goods or services being procured and the supply chain used by the businesses.

It would be unrealistic to carry out an assessment of local benefit for every purchase, so a percentage margin approach would be a simpler but effective method.

Some public organisations do not apply any margin other than if the quality and the price are the same, then the local business/supplier is preferred.

Others apply a higher margin by giving preference to businesses/suppliers that operate within their area and who provide goods and services of a similar quality within up to 5% of the best price.

If the margin is too high, then there is a risk of outside businesses not tendering or competing to supply. Without that competition there is a danger of prices rising and having a greater negative impact on the local economy.

Also outside businesses may bring skills and expertise that can assist in building the local capacity, particularly when they utilise local suppliers and sub-contractors.

A margin of up to 1% would appear to be an appropriate level of recognition of the contribution to the local economy.

As noted above any margin should reflect the extent to which the local economy benefits – not the perceived "local" versus "outsider".

Proposed Policy

Where attributes and prices are similar between businesses/suppliers, Council will give preference to local businesses/suppliers within a margin of 1% of the best price offered.

This policy does not apply where the procurement involves NZTA funding.

(NZTA sets out specific procurement guidelines for land transport works that are funded by government).

Proposed Guidelines

In determining what a "local business" is, Council will have regard to the extent to which those businesses/suppliers contribute to the local economy by taking into account the following factors:

- provide local employment
- use local suppliers
- use local subcontractors
- use local services
- use local subcontractors
- purchase locally
- manufacture locally
- produce locally
- add value locally
- build local capacity - train and develop locals
- contribute to local community (cash or kind)
- work with multiple objectives (e.g. including social & environmental)
- provide discounts for locals
- own local property
- lease local property
- have company office locally
- collaborate with local agencies/communities
- look for local innovative solutions
- provide local resources during emergencies

The margin will be applied on a pro-rata basis from 0% where there is no additional benefit to the local economy, and up to 1% where there is a significant contribution to the local economy. This will be a value based judgement rather than quantitative assessment.

Where the supply of goods and services is based on a specified quality, the margin, if applicable, will be applied relative to the best price offered.

Where the supply of goods and services is based on a weighted attribute or similar type process, the margin, if applicable, will be applied to the price component relative to the mean price of all the tenderers) before assessing the tenders in the normal way.

3. SIGNIFICANCE

Not applicable.

4. CONSULTATION

Not applicable.

5. COMMUNITY OUTCOMES

This will contribute to a "Prosperous Tairāwhiti" by using public spending to support and develop the local economy.

6. LEVELS OF SERVICE

Not applicable.

7. FINANCIAL

Not applicable.

8. LEGAL

There are no legal issues provided that the matter is included in the Procurement Policy.

9. POLICY

The Office of the Auditor-General has produced a good practice guide entitled "Procurement for Public Entities". The guide suggests that a public entity should develop its own procurement policies and procedures that are tailored to its working environment and that take into account the basic principles:

- Accountability
- Openness
- Value for Money
- Lawfulness
- Fairness
- Integrity

And the practical considerations:

- The goal
- Simplicity and proportionality
- Context
- Risk
- Nature of the Parties

A legal entity may have considerable discretion in how it procures goods and services and should be aware of developing an overly rigid or prescriptive procurement policy.

It is also important that there is a process for regular reviews of the policy to enable changes to be made that reflect changing circumstances.

10. OTHER CONSIDERATIONS

Not applicable.

11. APPENDICES

Procurement Policy.