Summary

2.001 Hospital and Health Services (HHSs) make large capital purchases, some recent examples of which have come in for questioning about the way that they were handled. Therefore, we decided to undertake a general review of HHSs' capital purchasing policies and practices.

2.002 Generally, we found good practice at the 11 HHSs where we carried out our review of 14 capital purchases. However, we also identified several areas where the HHS needed to improve its purchasing policies and practices.

2.003 Although these shortcomings did not necessarily significantly affect the outcome of the purchases we reviewed, the processes needed to be tightened so that the HHS could demonstrate that:

- it is achieving value for money when purchasing; and
- its processes are seen to be fair.

2.004 The positive things we noted from our review were that:

- In all but one case the HHS had documented purchasing policies and practices. The one exception was an HHS that had been established for only a year, and which has since developed purchasing policies and practices.
- The HHSs had a sound basis for the decision to purchase and (in all but two cases) they managed their overall capital expenditure in accordance with strategic priorities and business plans.
- In all but two purchases the HHS Board was involved at an early stage of the purchase process, was given adequate information, and sought appropriate advice on technical matters.
- For all 14 purchases a purchase specification was prepared – four by the HHS itself and 10 by an external consultant. In preparing the four specifications themselves the HHSs had sought specialist advice, consulted with users (where relevant), and had the specification independently reviewed (in all but one case).

- The HHSs tendered all 14 purchases. The majority were closed rather than open tenders. However, for the closed tenders the HHS's method of selecting the supplier was demonstrably fair.

2.005 The shortcomings we noted were that:

- The documented purchasing policies and practices of five of the HHSs did not meet our criteria. None of the five had documented practices for tender evaluation or pre-determined tender rules.
- These shortcomings were reflected in the individual purchases that we reviewed. For six purchases the HHS did not have predetermined tender rules and for four the HHS did not have pre-set evaluation criteria. In two of those four cases, the HHS evaluated tenders against the specification set out in the Request for Proposal or Business Case, and in the other two the HHS had some criteria that were not communicated to the tenderers

What Has Happened?

2.006 Since we undertook our review the Minister of Health has instructed all government departments and agencies associated with health to ensure that they follow good practices when spending public money. The over-riding consideration is to be accountability for spending tax-payers' money by a process that is transparent.

What Are We Doing?

2.007 Because proper purchasing procedures are important to the effective and efficient use of the public money that HHSs spend, we will maintain our watch on how they go about making capital purchases.

Why We Looked at Capital Purchasing

2.008 HHSs spent $229 million on capital purchases in the year ended 30 June 1998. This is a significant sum of money. In addition, over the last two years questions have been asked in Parliament about purchasing in the health sector. (We reported in September 1999 on the purchase by Capital Coast Health Limited of a new computerised information system.[1])

2.009 We looked at HHS purchasing polices and practices as part of our audit for the year ended 30 June 1998. The results of this preliminary review suggested that a more detailed review would be worthwhile. We therefore conducted an in-depth review as part of the audit for the year ended 30 June 1999 to establish whether HHSs:

- had documented purchasing polices and practices of an adequate quality; and
- were applying those policies and practices.

What We Looked At

How Did We Choose the Capital Purchases that We Reviewed?

2.010 We identified 44 capital purchases – comprising building projects worth over $1 million and information technology (IT) projects worth over $500,000 – that HHSs had approved since July 1997. We selected these two categories on the basis that:

- large sums of money are tied up in building projects; and
- IT projects (which are widely undertaken by HHSs) need to be properly specified to ensure their success.

1 *Fourth Report for 1999*, parliamentary paper B.29[99d], pages 11–45.

2.011 From the 44 purchases we selected a sample 14 for the purposes of our review. This sample was representative of HHSs and the two project types. Our selection process placed greater weight on the high-value projects, resulting in the sample comprising 46% of the total value of contracts approved (i.e. $133.9 million out of $288.7 million).

2.012 The sample of 14 consisted of seven building projects and seven IT projects, by 11 of the 23 HHSs.

How We Performed Our Review

2.013 We applied the criteria set out in our *Good Practice for Purchasing by Government Departments*.[2] We produced the *Good Practice* guide in 1995 after reviewing departmental purchasing policies and practices. We published the guide so that departments could use it as a benchmark when determining their own purchasing arrangements. However, we believe that the guide could be useful to other public sector entities such as HHSs.

2.014 In assessing whether the policies and practices used by each HHS for the purchases we selected complied with our guide, we had discussions with appropriate HHS staff and sighted relevant supporting documentation.

What We Measured the HHSs Against

2.015 In assessing the quality of the purchasing policies and practices that the 11 HHSs used, we looked to establish whether each HHS had met the following broad criteria:

- documented purchasing policies and practices;
- a sound rationale for the decision to purchase;
- appropriate involvement of the Board;
- a written purchase specification;
- an appropriate method of purchase;

2 ISBN 0 477 02848 9, September 1995.

- a predetermined set of rules for tender;
- sound practices to evaluate tenders; and
- an effective project management system.

Documented Purchasing Policies and Practices

Our Expectations

2.016 We expected that each HHS would have documented purchasing policies and practices to ensure that:

- the greatest value for money is achieved when purchasing; and
- tenderers are dealt with fairly throughout the purchasing process.

2.017 Specifically, we looked for evidence that the HHS had documented purchasing policies and practices that met the guidance in our *Good Practice for Purchasing by Government Departments*.

2.018 Both of the objectives stated in paragraph 2.009 are critical to the purchasing process. By not detailing the practices required to meet these objectives HHSs run the risk that:

- an error is made;
- the "best" supplier may not be selected; and/or
- the purchasing process may not be able to withstand scrutiny.

Our Findings

2.019 All but one of the 11 HHSs had documented purchasing policies and practices at the time of the purchases we reviewed. The exception was the New Zealand Blood Service, which was only formed in the first half of 1998 and was not fully operational until July 1998. It has since developed policies and practices.

2.020 However, of the 10 HHSs that had documented purchasing policies and practices, five did not fully meet the standards in our *Good Practice* guide. All five did not have specified practices for tender evaluation, nor did they have pre-determined tender rules.

Rationale for the Decision to Purchase

Our Expectations

2.021 We expected that each HHS would have a sound basis for the decision to purchase and that it was managing its capital expenditure in accordance with strategic priorities and business plans.

2.022 Specifically, we looked for evidence that the HHS had:

- ensured that the purchase was in line with its long-term strategic objectives;
- established the need to purchase;
- considered the effect of the purchase on clinical and financial viability over time;
- defined and identified the specific incremental benefits directly attributable to the purchase;
- completed a cost-benefit analysis and identified that cost savings or efficiency gains could not be achieved without the purchase; and
- considered all alternative options to the purchase including the "do nothing" option.

Our Findings

2.023 For six of the 14 purchases the HHS had sought funding support from the Crown by way of additional equity, and therefore had to prepare a business case for approval by the shareholding Ministers. The requirements for these business cases are set out in guidelines produced by the Crown Company Monitoring Advisory Unit (CCMAU).[3]

3 CCMAU: *Guidelines For Hospital and Health Services – Seeking Support for Capital Expenditure*, May 1998.

These guidelines require that the decision to purchase is fully justified, alternatives to the purchase are considered, and the costs and benefits of the purchase are assessed.

2.024 By the HHS preparing the business case these six purchases met our expectations.

2.025 For the remaining eight purchases (six of which were IT projects), the HHS had in each case:

- Established the need for the purchase – in relation to the IT projects this included year 2000 compliance, increasing maintenance costs, and bringing IT systems and control "in house". Both building projects were needed to meet service delivery requirements.
- Assessed the effects of the purchase on clinical and financial viability.
- Established the specific incremental benefits expected from the purchase.
- Established that the purchase would mean cost savings and increased efficiency.

2.026 For seven purchases the HHS had included the purchase in its business plan and established a linkage between the benefits of the purchase and the business plan objectives. One purchase (an IT project) had not been included in the business plan.

2.027 The analysis of the options to purchase was done well. All except three HHSs considered the various options – including the "do-nothing" option – and recorded the reasons why each was rejected. The three that did not do the analysis were purchasing IT replacements and they all considered replacement to be the only viable option.

Board Involvement

Our Expectations

2.028 We expected that the HHS Board would have been appropriately involved in the decision to proceed with a significant purchase.

2.029 Specifically, we looked for evidence that the Board:

- was involved at an early stage in the purchase process;
- was given adequate information on which to base its decision to proceed with the purchase; and
- received appropriate advice to enable it to understand any technical matters.

Our Findings

2.030 In all but one of the 14 purchases:

- the Board was involved in the purchase from the initial stages;
- the information supplied to Board members when making the decision to proceed with the purchase was of a good quality and included financial and technical reports from internal and external consultants.

2.031 In one case the Board had approved the inclusion of the project in its business plan, but the purchase had proceeded to the point of calling and receiving tenders before the Board approved it. By not approving the purchase until tenders were called the HHS increased the risk that the purchase process may have reached the stage where the Board was committed to proceeding with a purchase that it might not have otherwise made. In addition, the information supplied to the Board did not meet its own policies as there was no formal capital proposal form and there was a lack of user involvement and financial justification.

2.032 The Board had also received technical advice in all but one case, where the HHS was replacing its IT infrastructure. The new infrastructure purchase was the first step to provide the platform for a larger IT project and we understand that the Board received technical advice in relation to the larger project. If the Board does not receive adequate information and advice on technical matters, the risk is increased that the purchase will not necessarily meet the requirements of the HHS.

Written Purchase Specification

Our Expectations

2.033 We expected that each HHS would have prepared a clear, comprehensive, and accurate specification of exactly what it wanted to purchase, to ensure that the product purchased would do what it was needed to do.

2.034 Specifically, we looked for evidence that:

- the specification focused on the functional requirements of the product (what it is expected to do) and the physical characteristics of the product (for example, technical and operational requirements, performance standards and quality assurance requirements);
- the HHS had sought appropriate advice if it did not have the necessary technical expertise;
- the HHS had consulted with operational staff and other users to ensure that the specifications met their needs; and
- for purchases of a high value or technical complexity, or involving some other element of risk, the HHS had ensured that someone other than the preparer had evaluated the specification.

Our Findings

2.035 For all 14 purchases the HHS had prepared a purchase specification.

2.036 For 10 of the purchases the HHS used an external consultant (because of the technical and specialised nature of the purchase) to prepare the purchase specification.

2.037 In all relevant cases the users' needs were assessed when preparing the specification and, where an external consultant was used, an independent consultant evaluated the specification. (If someone other than the preparer does not review the specification, the risk that it has not addressed all aspects of the item to be purchased is increased. Unless the specification is correct the item purchased will not necessarily meet the needs of the organisation.)

2.038 The remaining four purchase specifications (which involved the purchase of IT equipment) were prepared in-house. For all four purchases the HHS had consulted with users where relevant, and all but one had the specification reviewed by someone independent of the person preparing it.

An Appropriate Method of Purchase

Our Expectations

2.039 We expected that each HHS would have used a purchase method – open tender, closed tender, or selective purchase – that it could demonstrate was the most appropriate to the circumstances.

2.040 Specifically, we looked for evidence that:

- The preferred method of purchase was an open tender[4] because it –
  - establishes the most competitive price and terms available;
  - explores or tests the market for alternative solutions; and
  - fulfils a public duty of fairness and equity between suppliers.
- If a closed tender[5] was conducted, the identification of suppliers was well founded, thorough and demonstrably fair.
- If a selective purchase[6] was made, the HHS had carefully considered and justified the reasons for using it, bearing in mind that –

4 Where all potential suppliers (subject to any practical limitation of reaching them all by advertising) are given the opportunity to tender.

5 Where invitations to tender are issued to a predetermined list of suppliers. This method has advantages when only a limited number of firms are believed to have the capability and when confidentiality is important, and it is not as costly as it limits the number of responses. The biggest disadvantage is that a better source of supply may be missed.

6 A purchase made from a supplier without having invited competing tenders from any other supplier.

- the most competitive price and terms may not be obtained;
- the best source of supply may not be found; and
- potential suppliers, whether known or unknown, will not be given an equal chance to compete for the business.

Our Findings

2.041 The methods of purchase used were:

Open Tender	3
Closed Tender	10
Part Closed Tender/Part Selective Purchase	1
Total	**14**

2.042 Where the HHS used the closed tender method of purchase, potential suppliers were identified with the assistance of external consultants, project managers or in-house technical staff.

2.043 The one instance of partial selective purchase was for installation of computer and telephone cabling. Selective purchase was used because the installer was already the preferred supplier of communication systems for the site redevelopment and was the main provider in New Zealand.

2.044 Overall, we consider the methods were demonstrably fair – except in one case where the lack of documented evidence meant that we were not able to form an opinion. This lack of evidence increases the risk that the HHS would not be able to establish that its selection process was fair should it be challenged.

Predetermined Tender Rules

Our Expectations

2.045 We expected that each HHS would have conducted the tender in accordance with a predetermined set of rules, and advised tenderers what the tender rules would be and how they were to be applied.

2.046 Specifically, we looked for evidence that there were tender rules governing:

- the conditions of tender;
- acceptance of tenders;
- late tenders;
- tender evaluation criteria;
- due diligence enquiry; and
- post-tender negotiations.

Our Findings

2.047 For the 14 purchases:

- In five cases the HHS conducted the tender in accordance with a predetermined set of rules.
- In three cases the HHS had no predetermined rules but the tender was conducted in conjunction with an external consultant or project manager and standard industry rules of tender were adopted. In these cases we accept that the purchases met our criteria.
- In the other six cases the HHS had no predetermined rules.

2.048 Not having predetermined tender rules increases the likelihood of uncertainty between the HHS and potential suppliers as to what rules are to be applied to a particular purchase. The absence of rules also increases the risk that an individual tenderer might feel treated unequally or unfairly compared with other tenderers, and publicly disputes the tender process.

Tender Evaluation Practice

Our Expectations

2.049 We expected that each HHS would have established a sound set of practices by which it could evaluate tenders on a consistent and defensible basis.

2.050 Specifically, we looked for evidence that the HHS had:

- decided how the tenders would be evaluated before calling them;
- included in the tender documents reasonable particulars of what evaluation criteria were to be applied;
- used a range of appropriately skilled people to evaluate the tenders; and
- adequately documented the evaluations so as to demonstrate that it gave proper consideration to, and had reached a sustainable decision on, each tender.

Our Findings

2.051 We encountered a variety of approaches to tender evaluation. The approaches can, however, be grouped into two broad categories:

- those used where the HHS conducted the tender itself; and
- those used where the HHS, because of the specialised technical nature of the purchase, employed an external consultant to conduct the tender.

2.052 For six of the 14 purchases (all for IT) the HHS conducted the tender itself.

2.053 For two of these six purchases the HHS fully met our expectations by having pre-set evaluation criteria. For two other purchases the HHS did not have pre-set evaluation criteria but used an alternative such as the specification for purchase set out in the Request for Proposal or Business Case. For the remaining two purchases the HHS had some criteria but they were not communicated to the tenderers.

2.054 Teams of evaluators were used for all six purchases. In four cases the teams contained people with technical and commercial knowledge – one team comprised nine users covering all professional groups and business processes within the HHS. In the other two cases the team members were solely from an IT background. However, in one of those two the final sign-off for the project was the responsibility of the Chief Financial Officer.

2.055 The evaluations were documented and provided evidence of how tenderers were differentiated.

2.056 For the eight purchases (one IT and seven building) where the HHS employed a project manager to conduct the tender on its behalf:

- The evaluation criteria used were industry standards or the purchase specification (in most instances this was the building specifications). Once compliance with the building specifications had been established and the cost was within an allowable range, the contract was awarded to the lowest cost tenderer.
- The project manager evaluated the tenders.
- The project manager retained the evaluation documentation. The HHS received a summary of the tender process, the evaluation results, and a recommendation as to the successful tenderer.

Project Management

Our Expectations

2.057 We expected that the HHS would manage each purchase project to ensure that it was completed:

- according to the specifications;
- within budget; and
- on time.

2.058 Specifically, we looked for evidence that each project:

- was managed by a qualified person;
- had a detailed implementation plan which allowed for "go/no go" break points or "off ramps";
- had a reporting regime in place to monitor progress, cost and compliance with the specification; and
- had a post implementation review.

Our Findings

2.059 A project manager was appointed to oversee each project. External consultants were appointed to manage five out of the seven building projects (because of the specialised nature of the purchases). All had previous experience managing similar projects. For the other two building projects the HHS appointed a suitably qualified internal staff member to be the project manager, both of whom had considerable experience in similar projects elsewhere.

2.060 Of the seven IT projects:

- In four cases an HHS staff member (the IT manager) was appointed to manage the project on the basis of their knowledge and experience in the industry.
- In the other three cases human resource and consulting firms appointed an external project manager after a selection process. All three were appointed on the basis of their qualifications, knowledge and experience within the industry relevant to the project specifications.

2.061 Only one project did not have a detailed implementation plan – however, the HHS did monitor the costs of the project against budget. For the other 13 a robust programme for reporting progress against the plan was employed.

2.062 Eight of the implementation plans provided for a "go/no go" break point to identify where the project might have deviated significantly from the plan and (if necessary) allow for a decision to be made whether to proceed and (if so) on what basis. Where the plan did not provide for a break point, in one case the HHS thought the time involved was too short and in three cases the HHS thought that close monitoring would have revealed the need for the project to be reviewed if necessary.

2.063 At the time of our review only two projects had been completed. For one the HHS had completed a post-implementation review, and for the other the HHS told us that it would be completing a review shortly.