



Performance audit report

Spending on
supplies and
services by
district health
boards: Learning
from examples





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Spending on supplies and services by district health boards: Learning from examples

This is an independent assurance report about a performance audit and other auditing work carried out under sections 15, 16, and 17 of the Public Audit Act 2001.

September 2010

ISBN 978-0-478-32673-4 (print)
ISBN 978-0-478-32674-1 (online)

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Auditor-General's overview

Together, the 20 district health boards (DHBs) spend about \$6 billion of public money purchasing supplies and services from external organisations each year. Total DHB spending each year is about \$10 billion. Spending on supplies and services is clearly an integral part of any DHB's ability to provide health and disability services to the public.

How well DHBs spend money is important, and of interest to Parliament, the public, and the DHBs. We all expect DHBs to manage their spending on supplies and services well, for two main reasons. First, even small improvements in how DHBs manage their spending on supplies and services could increase the money available to provide for additional health and disability services – contributing to an improvement in the overall health of New Zealanders without increasing the overall amount of money spent. For example, an average 1% saving by all DHBs would mean about \$60 million each year that could be used for additional health and disability services.

Secondly, all forms of purchasing are a prime risk for any organisation in terms of waste, theft, fraud, and other illegal or unethical uses of money. Carefully managing the processes used for purchasing and contract management can greatly reduce that risk.

In the health sector, my staff have carried out systematic work in all DHBs as part of the annual audit and reporting cycle, and more in-depth work with five DHBs. Together, this work has given us a reasonably clear picture of how well DHBs are managing their purchasing and contract management (collectively called “procurement”).

This report brings together what my Office has learned during the last three years about how DHBs are managing the processes of spending money on supplies and services and determining value for money. It identifies four critical questions that DHBs need to ask to determine whether they are managing the processes of spending money on supplies and services well and ensuring value for money:

- Are we spending the money on the right supplies and services (the things we need to achieve our objectives/outcomes)?
- Are we purchasing supplies and services in the right way (appropriately managing risk and demonstrating value for money)?
- Do we know whether we are getting the supplies and services we thought we were buying (the right quantity and quality at the right time)?
- Are we paying enough attention to procurement?

To share what we have learned and improve sector knowledge, this report gives examples from practices my staff observed in DHBs. These examples are intended to let DHBs compare their own practices and to help them determine how they can further improve the processes they use to spend money.

Part 3 of this report describes the good practices and improvements we have noted during the last three years. However, we have also noted some practices that need to improve further (see Part 4). I encourage DHBs – and all other public entities – to reflect on all these examples, and consider whether and how they could improve their own practices.

We consider that senior managers, Board members, and others who have responsibility for improving procurement in their DHB, might find a brief, high-level guide to procurement useful. In the Appendix and in a separate summary sheet, we have summarised how the processes for spending money on supplies and services can be most effectively improved by:

- recognising the significance of procurement;
- supporting procurement activity;
- making procurement easier;
- managing risk; and
- monitoring performance.

Spending money on supplies and services is integral to every DHB's ability to deliver health and disability services, and it needs a strategic approach. That approach has to be based on comprehensive knowledge about which supplies and services are needed (now and for the future) and why they are needed (how they will contribute to delivering better health or greater independence for New Zealanders).

The attention to, and resourcing of, procurement needs to reflect this strategic importance. Senior managers and appointed Boards need to take a "helicopter" view of the DHB's procurement activity, ensuring that purchases align with the DHB's strategic direction and that the purchasing approach is appropriate for the supplies and services that are purchased.

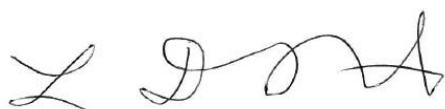
Allocating resources to procurement is a challenging task, given the limited number of people with specialist procurement training, the demand for such people, and the constraints of the current economic environment. Training and developing their staff and sharing knowledge and experience within and between DHBs are two ways in which DHBs are coping with these challenges.

Procurement is not an exact science; it requires a good mixture of controls, risk management, and well-informed judgement in both purchasing and contract management. It also requires a level of investment in these controls, risk management processes, and information systems in proportion to the scale and complexity of procurement activity.

Procurement also requires a focus on the end result at all times to make sure that the procurement meets the needs of the DHB. Important decisions should drive the purchasing process, rather than the process driving the decisions.

Because procurement is fundamental to the effective and efficient delivery of supplies and services, DHBs need to give it an appropriate level of internal scrutiny.

I am publishing this report at a time when changes in the health sector will affect how some purchasing is managed. This report should help the organisations created to improve purchasing in the sector (such as Health Benefits Limited) to understand the current challenges that DHBs face in procurement, and to further develop good practice. Many of the issues identified in this report will remain relevant for DHBs and the organisations assisting them with procurement.



Lyn Provost
Controller and Auditor-General

14 September 2010



Spending on supplies and services: Where to focus first

A summary from *Spending on supplies and services by district health boards: Learning from examples*, September 2010.

Procurement can be a complex area. With limitations on resources, it is important to prioritise which aspects to focus on first. We have identified the most important improvements that district health boards (DHBs) could make to enhance the effectiveness and efficiency of procurement in contributing to the overall business of the DHB.

Recognise the significance of procurement

Procurement must be treated as fundamental to the effective and efficient delivery of services. It should be managed strategically, in proportion to its scale, and recognised as involving a significant amount of money.

This means taking a “helicopter” view of the DHB’s procurement activity and dealing with procurement strategically across the breadth of DHB activity now and for the future – both for purchasing and contract management. It also means actively considering what you want to achieve from procurement activity and setting appropriate business objectives.

To set appropriate business objectives, you need to fully understand the total extent of procurement activity throughout the DHB:

- Funding agreements with non-governmental organisations (NGOs) are procurement activity, even though the approach to purchasing services delivered by NGOs may need to be different. Consider strategically the DHB’s best procurement approach for these agreements, both the purchasing approach and the specific approach to contract management (the tools and techniques needed to manage the quality of service delivery).
- Raising a purchase order for supplies or services that are not under a contract is also procurement, even though these purchases are often relatively simple. It may be that a simple purchase order is an appropriate approach for these purchases. However, it

may be that a different approach to these purchases would be more efficient.

- Clinical staff are often involved day to day in raising purchase orders or managing the delivery of a contract. They are therefore involved in procurement.

Consider these issues from your “helicopter” view, and determine an appropriate approach based on a full understanding of how each purchase fits the bigger picture.

Clarify how much risk the DHB is prepared to take (its strategic risk appetite) in procurement matters, and use this guidance to apply the appropriate levels of effort in purchasing and contract management processes.

Allocate adequate resources to the task of procurement. Ensure that you have appropriate information systems to collect and collate information to report on procurement matters, and involve procurement in strategic and business planning.

Recognise that procurement needs to involve an understanding of the business. Therefore, procurement staff need to work with staff involved in service delivery to ensure that procurement staff are purchasing supplies and services fit for their purposes.

Support procurement activity

Invest in procurement staff and their continuing development. They are a DHB’s best response to procurement risk, but they need to be kept up to date with developments if they are to contribute their best. They will gain exposure to

new initiatives that may deliver better results than current practices. Continuing professional development also works to develop the pool of procurement talent and experience, reducing the risks of turnover of experienced staff.

Share good practice and new ideas within the DHB and with other DHBs. If a new procurement initiative works well once in one DHB, it may well work for others. If the information is shared between DHBs, they may also share information about what worked well for them. All DHBs can potentially save time and effort from avoiding the need to “reinvent the wheel”.

Make procurement easier

Develop information systems to provide procurement information for management. Although many DHBs are improving their management information about purchasing and contract management activities, there is much that can still be done to improve, both in terms of the technology systems to support data gathering and in the analysis of the data to produce information useful to senior management and the Board.

Prepare better guidance for staff on procurement practice expectations. Standardise processes and documents for tailoring to individual circumstances and provide appropriate guidance about tailoring for scale and risk.

Manage risk

Raise the profile of risk management throughout the procurement process, both in terms of purchase risks and risks with managing the delivery of the supplies and services. Consider the possibility of providing a generic risk assessment or a risk assessment workshop to assist those unfamiliar with risk management.

Manage “pockets” of procurement activity according to business needs and risks. Smaller pockets of procurement may need support, but do not need to be overwhelmed by overly

complicated processes. Understand the business needs and risks, and tailor the procurement approach to suit. Develop delegations and purchasing thresholds to suit the business needs and risks.

Manage risks consciously. Sometimes, DHBs are unwittingly accepting procurement risks because they have failed to consider all risks in a systematic way. Actively consider the risks associated with procurement and the responses required to reduce or manage those risks, particularly the risks around the underlying principles of openness, fairness, and value for money.

Consider risk early in the procurement process – more considered thought during planning generally leads to more considered responses to risks appropriate to the likelihood and consequence of the risk event occurring. Document the risk response and monitor whether it has the desired result. Amend the response if it does not. Consider new risks that may arise during the procurement process. Effective risk management is ongoing.

Keep the end objective of the procurement in mind at all times – do not let the process drive the decisions, but make the decisions drive the process).

Monitor performance

Monitor procurement activity in proportion to its scale – give it the attention that an activity representing between 36% and 70% of total spending deserves.

Review procurement activity regularly for compliance with policy and procedure. Review the adequacy of risk management consideration and response.

Report the results of this review activity and the results of the procurement activity (including the measurement of achievement against the business objectives) to senior management, the Audit Committee, and/or the appointed or elected members of the Board (as appropriate).

Part 1

Introduction

- 1.1 District health boards (DHBs) spend a lot of money on supplies and services from external suppliers and providers, amounting to between 36% and 70% of all the money that each DHB spends each year. Information from a self-review questionnaire that we sent to all DHBs in 2007/08¹ indicates that, collectively, this spending amounts to about \$6 billion each year.
- 1.2 Because this is a lot of money, and because there is a keen public interest in how this money is spent and whether it is good value for money, we have been looking more closely at the ways in which DHBs are spending money on supplies and services from external suppliers and providers.
- 1.3 We have identified four critical questions that DHBs need to ask themselves to determine whether they are managing the processes of spending money on supplies and services well and ensuring value for money:
- Are we spending money on the right supplies and services (the things we need to achieve our objectives/outcomes)?
 - Are we purchasing supplies and services in the right way (appropriately managing risk and demonstrating value for money)?
 - Do we know whether we are getting the supplies and services we thought we were buying (the right quantity and quality at the right time)?
 - Are we paying enough attention to procurement?
- 1.4 This report provides examples of good practices that we encourage, and some examples of poor practices, to help DHBs consider their own practices in spending on supplies and services from external suppliers and providers.

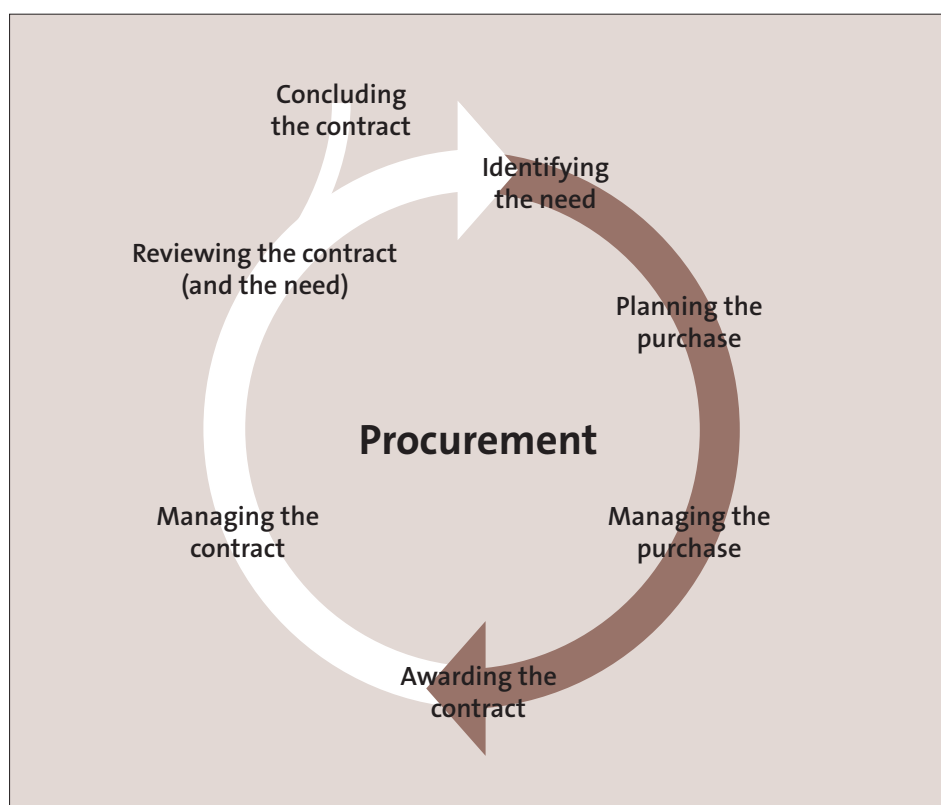
Terminology and the district health board context

What is procurement?

- 1.5 **Procurement** refers to all of the business processes associated with purchasing. It spans the whole lifecycle (see Figure 1), from identifying needs to the end of a service contract or the end of the useful life and subsequent disposal of an asset. Procurement includes **contract management** as well as **purchasing**.

¹ Not all of the responding DHBs were able to provide a breakdown of their spending on supplies and services from external suppliers and providers.

Figure 1
Purchasing and contract management phases in the lifecycle of procurement



What is purchasing?

- 1.6 **Purchasing** is spending money on supplies and services from external suppliers and providers. It is not spending money to employ staff, nor is it spending money to service debt. But it is spending money on almost everything else.

What is contract management?

- 1.7 A contract or agreement refers to the legally enforceable obligations, and any associated conditions, that two or more parties have agreed they owe to each other. The terms of a contract will often be recorded in writing but do not have to be. There will always be a contract in a purchasing relationship, even if the form of the contract is a purchase order.
- 1.8 In DHBs, contracts for funding non-hospital-based health services are often called "Health Service Agreements" or "Funding Agreements".

- 1.9 **Contract management** refers to all of those processes used to monitor and manage the external supplier's or provider's performance to assess whether the DHB is receiving, and paying for, supplies or services of the right quality and quantity, as agreed in the contract.
- 1.10 Contract management covers both managing the specific requirements of the contract and managing the relationship with the external supplier or provider of the supplies or services.
- 1.11 An assessment of the risks associated with the contract and the costs or benefits of the contract management processes determines the extent of contract management activity.

What supplies and services do DHBs spend money on?

- 1.12 DHBs have historically organised and referred to their spending on supplies and services in three categories:
- corporate;
 - provider; and
 - funder.
- 1.13 DHBs use the term **corporate** to categorise spending on the supplies and services needed for the efficient running of the DHB. These include, for example, support services for administration and patient management software systems, computer equipment, financial management software, photocopier paper, and legal services.
- 1.14 DHBs use the term **provider** to categorise spending on the hospital-based services that the DHB **provides**. In this category, money is spent on the supplies and services that the DHB needs to provide and operate the physical environment in which hospital-based services are delivered. These supplies and services vary considerably and include:
- supplies and services needed to manage the hospital buildings and infrastructure, including new building/car park construction (for example, architects' and building contractors' services), refurbishment and maintenance of existing buildings (for example, plumbing and electrical parts and services, and lift maintenance services), and landscape maintenance (such as lawn mowing and tree trimming services);
 - supplies and services needed for the hospital to function (including laundry services, security, food services, linen supplies, toilet paper, and hospital beds);
 - supplies that are consumed in delivering hospital-based services (including medicines, bandages, gloves, and blood products); and

- medical or surgical tools and equipment needed to deliver hospital-based services (including intravenous equipment, x-ray machines, scalpels, and sterilising equipment).
- 1.15 DHBs use the term **funder** to categorise spending on services that are not based in the hospital (non-hospital services) but are **funded** by the DHB. In this category, money is spent on funding external organisations to deliver non-hospital services. Examples of these services include residential care for the elderly, mental health services, and programmes for targeted populations (such as assistance for breastfeeding mothers, diabetes checks, immunisation programmes, “well child” checks, Pacific health programmes, and whānau-based care programmes).
- 1.16 DHBs refer to procurement for corporate and provider contracts as their “provider arm” procurement. They refer to procurement for funder contracts as their “funder arm” procurement.
- 1.17 Information we gathered from DHBs in 2007/08 indicated that funder purchases represent between 41% and 77% of all purchasing by DHBs. Smaller DHBs spend a larger proportion of their money funding external organisations to deliver non-hospital services. Larger DHBs spend proportionately more on providing hospital services.
- 1.18 There are some signs that these historical divisions of spending may be changing. For example, DHBs may include the purchasing requirements of some non-governmental organisations (NGOs) that deliver non-hospital services for the DHB, where there are efficiencies in doing so.
- 1.19 DHBs are increasingly purchasing hospital services from other providers (for example, from private hospitals in the district). In this case, the DHB is funding rather than providing hospital services.

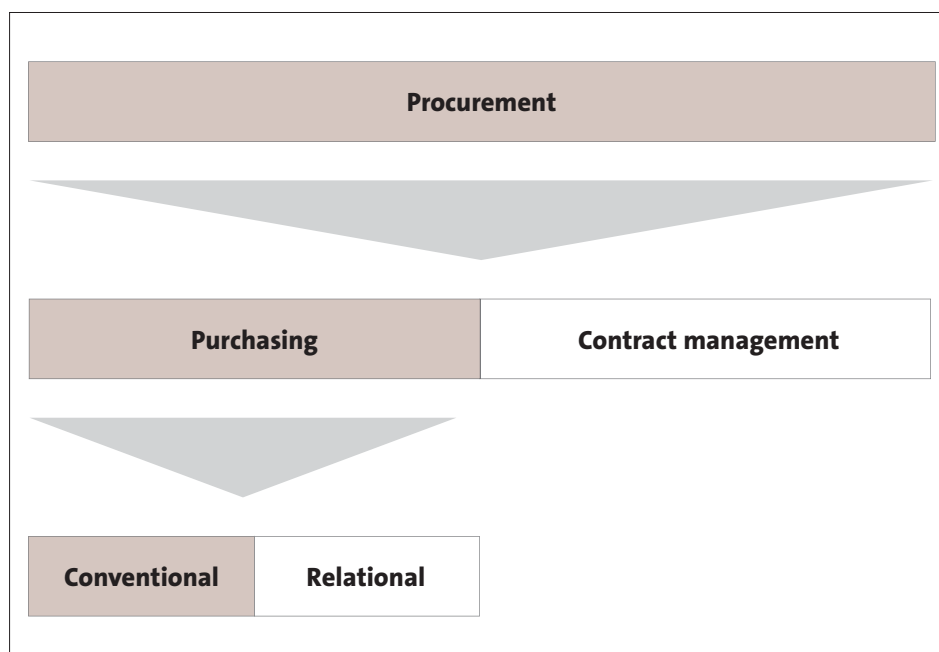
Is purchasing the same as funding non-governmental organisations to deliver health services?

- 1.20 In providing funding for NGOs to deliver health services, the DHB is actually purchasing those services from the NGO. The DHB is still responsible for determining whether the services are delivered to the right groups of people and are of the right quality (that is, that they are achieving the desired results).
- 1.21 We know that DHBs may not have much choice about which organisations they can purchase some of these services from. For example:
- where an NGO has met certain quality standards for delivering some health services, the DHB may be obliged to provide funding for them to deliver those services (often under nationally agreed terms and conditions);

- the health services may be targeted at certain people and there may be NGOs that are already delivering other targeted health services to the same group of people;
- there may be only one NGO capable of delivering the health services; and
- the users of the health services may have an expectation about who they receive the health services from.

1.22 These circumstances do not mean that the funding arrangements are not purchasing activity. However, they may guide the DHB on the most appropriate way to purchase these services. The DHB may choose to use a **relational purchasing** approach, rather than a **conventional purchasing** approach, for these services (see Figure 2).²

Figure 2
The components of procurement



What is the difference between conventional and relational purchasing?

1.23 In a **conventional purchasing** environment, ordinary market disciplines (competition between suppliers or providers) can be expected to operate well to manage value for money. However, there may not be an effective market in place

² For further discussion on the definitions and differences between conventional and relational contracts, see Part 4 of our June 2008 publication *Public sector purchases, grants, and gifts: Managing funding arrangements with external parties*, which is available at www.oag.govt.nz.

for some of the supplies and services that DHBs purchase. Therefore, DHBs may decide to give greater weight to the relationship with the supplier or provider and use means other than market-based systems to manage value for money. This is called a **relational purchasing** approach.

- 1.24 Other factors that suggest a conventional approach might not fit the purchase, and that the purchase might be better thought of as having a significant relationship dimension, include:
- the strategic importance to the DHB of the supplies or services (such as blood products) or of the relationship with the provider (such as a national provider of mental health services);
 - the nature of the supplies or services purchased (such as health programmes targeted at specific ethnic groups), where the relationship with the provider is a significant aspect of effective service delivery;
 - the continuity and duration of the relationship between the DHB or external party and the end user (such as a person receiving aged residential care services); and
 - the specialist nature of the supplies or services (such as specialist professional advisory services).
- 1.25 A relational approach to purchasing does not change the fact that the purchase needs to be made in the context of the DHB's strategic direction, supporting its service delivery priorities, and that the underlying principles of procurement – accountability, openness, value for money, lawfulness, fairness, and integrity – still apply.
- 1.26 One model being created in primary health care³ is to take a whole-of-system approach to integrate, and make sustainable, the delivery of health services. This involves a new form of funding and managing the service delivery, based on a high level of trust in the relationship between the DHB and a range of NGOs.
- 1.27 The resulting contractual arrangement is not that the DHB purchases services from one provider. Instead, the DHB and many organisations work together to deliver non-hospital services in what is called an “alliancing” arrangement.

3 This model is being developed by the Canterbury Clinical Network, “[a] consortium of health care leaders, including representatives from urban and rural general practitioners and practice nurses, Manawhenua ki Waitaha, hospital specialists, district (community) nurses, pharmacists, physiotherapists, Canterbury DHB ... Planning and Funding management, Primary Health Organisations ... and Independent Practitioner Associations ...”. See: *Summary Implementation Plan to deliver better, sooner, more convenient health care in Canterbury 2010–2013*, Canterbury Clinical Network, page 2.

Relevance of this report

- 1.28 The Ministerial Review Group's report⁴ recommended changes to "consolidate back office functions across the 21 DHBs⁵ and harness the power of bulk purchasing". A Crown-owned company, Health Benefits Limited (HBL), has been set up to implement some of the recommended structural and procedural changes. One of HBL's objectives is to secure efficiencies in, and improve the effectiveness of, health sector procurement activity.
- 1.29 As a result of setting up HBL, changes are likely in the way in which the sector manages procurement. Regardless of the structural and service delivery changes that occur, there will still be a high level of purchasing and contract management activity for all of the supplies and services required by the 20 DHBs. Therefore, this report is relevant for any entity that is responsible for purchasing or contract management activity regardless of whether that entity is a DHB, a shared services organisation, a business unit of the Ministry of Health, or some other entity.

What we have looked at

- 1.30 This report is the result of a range of work on procurement policies and practices that we have completed in DHBs in the last three years (see Figure 3).

What we have learned

- 1.31 DHBs are increasingly focusing on improving the processes they use to spend money. In many DHBs, purchasing is currently given a greater improvement focus than contract management, though most DHBs recognise that contract management is also an important activity in making sure they are getting good value for money. DHBs are generally putting more effort into improving their provider and corporate purchasing than their funder purchasing.
- 1.32 There is a need to get procurement right both at the strategic level (throughout the DHB) and at the detailed level of each procurement. In presenting what we have learned from the work we have done in the last three years, we are seeking to help DHBs answer the four key questions we posed in paragraph 1.3. Therefore, we have structured our report as follows:
- What are the essentials of procurement that DHBs must get right? (Part 2)
 - What are DHBs doing well (or what key improvements have we seen) and why is it good? (Part 3)
 - What needs to improve and why does it matter? (Part 4)

⁴ A Ministerial Review Group was established in January 2009 to recommend how New Zealand might improve the quality and performance of the public health system. Its report, *Meeting the Challenge: Enhancing Sustainability and the Patient and Consumer Experience within the Current Legislative Framework for Health and Disability Services in New Zealand*, was issued in July 2009.

⁵ After the amalgamation of Otago District Health Board and Southland District Health Board, there are now 20 DHBs.

- 1.33 We have identified five main improvements that DHBs should focus on. These are:
- recognising the significance of procurement;
 - supporting procurement activity;
 - making procurement easier;
 - managing risk; and
 - monitoring performance.
- 1.34 These improvements cannot happen without commitment and action from appointed Boards and senior management within DHBs. We have expanded on these five main improvements in the Appendix and the separate summary sheet that accompanies this report.

Figure 3

Work we have carried out, in the last three years, on DHBs' procurement policies and practices

Work performed	Details
Review of procurement policies and procedures	We reviewed all DHBs' procurement policies and procedures during the annual audit in 2006/07. We have updated this work each year to identify the changes that DHBs have made.
Self-assessment of procurement practices	In 2007/08, we circulated a self-assessment form to all DHBs. This form asked DHBs to complete a series of questions about their procurement practices. We analysed their responses to provide an initial picture of each DHB's procurement practices and used this to inform our subsequent work.
Detailed review of procurement at two DHBs	In 2007/08 and 2008/09, we carried out further detailed work on procurement policies and practices at two DHBs. This work was an extension to the annual audit work to address some particular concerns about the procurement practices in those two DHBs.
Performance audit work	We selected three DHBs and carried out performance audit work on their procurement practices in 2008/09. At each of the three DHBs, we reviewed a sample of contracts to assess the purchasing and contract management processes. We reviewed a total of 123 contracts during this performance audit work.
Assessment of procurement practices	We studied the results of an assessment of the procurement practices of 11 DHBs conducted during the 2008/09 annual audit. At each of these DHBs, we reviewed a small sample of contracts to determine how these DHBs were managing risk in the process of spending money.
Additional assurance work on procurement	We have drawn on the findings of our detailed work at 14 DHBs on 41 separate occasions, which was completed to provide assurance to those DHBs on specific instances of their procurement practice.

Part 2

The essentials of procurement

- 2.1 In this Part, we set out the essentials of effective and efficient procurement.
- 2.2 The guidance in this Part should help senior management and Boards make sure that DHBs are spending their money well. The guidance also highlights the most important aspects of purchasing and contract management practices for those with hands-on roles in procurement. It should also be useful for those entities, such as HBL, with a role in the effectiveness and efficiency of procurement processes throughout the health sector.
- 2.3 The essentials of effective and efficient procurement are consistent with the basic principles that govern the use of all public funds. These principles are accountability, openness, value for money, lawfulness, fairness, and integrity.⁶

Procurement is integral to the business of district health boards

- 2.4 Between 36% and 70% of all the money each DHB spends annually is spent buying supplies and services from external suppliers and providers. Therefore, procurement needs to be recognised for what it is – a fundamental part of delivering effective and efficient services. Procurement planning is an integral part of the process for planning the effective delivery of services by DHBs. Procurement monitoring provides information about business performance.
- 2.5 Where funding constraints exist, DHBs could use more effective and efficient procurement practices to realise savings that do not affect levels of service. Sound processes for initiating purchases will also help protect the resources of the DHB from being wasted through inadvertent error and fraudulent activity, ensuring that all possible resources are directed to the delivery of services.
- 2.6 Procurement deserves a level of resourcing and attention from senior management and governing bodies that recognises its importance to the DHB.

Purchasing needs a strategic approach based on comprehensive knowledge

- 2.7 At the level of individual purchases, processes can be put in place to determine that each purchase represents good value for money. However, there is a risk that the individual purchase may not provide the best value for money for the DHB if it is made without the DHB knowing:
- what other supplies and services it currently purchases;
 - which suppliers and providers it uses;

⁶ For definitions of these principles, see paragraph 2.3 in our June 2008 publication, *Procurement guidance for public entities*, which is available at www.oag.govt.nz.

- why it needs those particular supplies and services; and
 - what the future demand will be for those and other supplies and services.
- 2.8 For example, aggregating the required amount of the same supplies throughout the DHB and negotiating a price and delivery service levels for the consolidated purchase is likely to be more efficient than purchasing smaller amounts of the same supplies separately for individual departments. Knowing which departments within the DHB need which supplies and when can generate efficiencies by reducing internal DHB processing and by increasing the ability to negotiate better pricing or delivery service levels because of the increased volume. Similarly, combining the purchase of similar categories of supplies and services may also provide opportunity for efficiencies.
- 2.9 Effective and efficient purchasing needs to be informed by a comprehensive picture, for all activity in the DHB, of:
- what supplies and services are needed, now and for the future;
 - what volumes of those supplies and services are needed;
 - where those supplies and services are needed;
 - when or how often the supplies and services are needed;
 - why those particular supplies and services are needed;
 - who those supplies and services are currently purchased from;
 - what purchase methods are being used;
 - the terms and conditions of those purchases and the expiry date of any formal contractual purchasing arrangements; and
 - the performance of the supplier(s) or provider(s) in delivering the supplies and services.
- 2.10 Purchasing also needs a good understanding of the supplier/provider market (not just who is in the market, but their capability and capacity for delivery and their financial sustainability), and a broader understanding of the purchases made by other DHBs and organisations purchasing similar supplies and services.
- 2.11 Having this information available lets DHBs take a “helicopter” view of their purchasing needs. They can strategically plan to manage the risks for:
- what is purchased (including how purchases may be combined together for efficiencies, and how the supplies and services required may change over time);
 - what the most appropriate purchase approach may be for different categories of supplies and services (including working collaboratively on a regional or national basis); and
 - ensuring continuity of delivery of supplies and services (where necessary).

Good planning relies on good data systems and good data analysis

- 2.12 DHBs' information systems for purchasing need to be robust enough to provide the comprehensive picture required for strategic (and individual) purchase planning at local, regional, and national levels.
- 2.13 This means making sure that all information systems that record purchasing data (regardless of whether they are hard copies or electronic records) for all DHB activity are able to be combined in some manner and analysed to provide the complete picture. In addition, information systems that identify the delivery of supplies and services also need to be "mined" for useful procurement data.
- 2.14 The information systems that record purchasing data will include purchase order systems, contract management systems, accounts payable systems, and inventory management systems. They may also include patient management systems (for data about the historical demand for supplies and services), complaints systems (for information about the performance of suppliers and providers), asset management systems (for information about planned purchases for maintenance or replacement of assets), and others.
- 2.15 Ideally, where these systems are integrated, the DHB will be able to easily determine the comprehensive picture required for strategic planning. Where these systems are not integrated, greater analysis will be needed to join the pieces of the picture together.
- 2.16 In addition, the ability of HBL to achieve its expected purchasing effectiveness and efficiency gains will depend on the early establishment and analysis of baseline data for all 20 DHBs.

Detailed planning is also essential

- 2.17 Knowing the context for a purchase and that it has a place in the DHB's strategic planning is not enough. Good planning for each purchase is essential for effective and efficient purchasing. Planning needs to make clear:
- who is responsible for the purchase process;
 - what exactly is to be purchased (the scope, volume, and value of the supplies or services to be purchased);
 - when the purchases are required;
 - what approach will be taken for the purchase and why that approach has been selected;
 - what the key factors are that will represent good value for money, so an

appropriate supplier/provider can be selected and delivery performance can be evaluated;

- what the risks in the purchase are and how they are to be mitigated or managed; and
- who is delegated the authority to approve the purchase decision.

- 2.18 Good planning also includes documentation of planning decisions and approval of the purchasing approach and processes. Good planning is conducted early enough to enable the purchasing process to be completed either before existing arrangements for the purchase expire (for supplies and services of a continuing nature) or before the supplies and services are needed (for new purchases).

Consider scale and risk in procurement

- 2.19 In procurement, one size definitely does not fit all. DHBs need to consider the scale and risk of their procurement in determining what level of effort is required to:
- purchase the supplies and services; and
 - provide enough oversight to ensure that the purchased supplies or services are delivered as agreed.
- 2.20 The principles underpinning procurement⁷ should always apply, but how these are applied in practice may differ from case to case. Everything we recommend as good practice may not be necessary to the same level for every purchase. Low-risk and low-value purchases will require different efforts, levels of formality, levels of documented support, and approval than complex or high-risk and/or high-value purchases. Similarly, simple supplies with a once-only delivery will require less contract management effort than the delivery of complex health services to the community over time.
- 2.21 DHB purchasing and contract management processes need to be flexible to enable different responses to different levels of scale and risk. Staff need to be given guidance to help them to apply this flexibility appropriately in practice.

Policies and procedures need to be useful to guide decision-making

- 2.22 Policies provide a framework for procurement decision-making, and procedural guidance provides staff with an understanding of how to apply the policies in practice.
- 2.23 Good procurement policies are clearly written, consistent with other DHB policies, and regularly reviewed and updated (as necessary). They describe the DHB's

⁷ Accountability, openness, value for money, lawfulness, fairness, and integrity.

overall “attitude” to procurement and set rules about requirements. They need to clearly distinguish mandatory requirements from those that require judgement. They need to link to other DHB policies that may affect procurement (such as conflicts of interest, gifts and hospitality, sponsorship, and delegated authorities). Importantly, they need to cover both purchasing and contract management.

- 2.24 Good procedural guidance should be detailed enough to help new staff to understand the ways in which the policy is put into practice. It should assist the application of judgement where this is allowed and provide guidance about when, how, and to what extent judgement should be applied. It should also describe the processes that must be followed and the tools that are available.

Experienced and capable staff are essential

- 2.25 Having experienced and capable staff will go a long way to offset the risks to DHBs in procurement activity. Experienced and capable procurement staff are a valuable resource. They are also in high demand but short supply in New Zealand. Their skills are sought by the private sector as well as the public sector. DHBs should make the most of the experienced and capable staff they have by sharing their knowledge widely and investing in their continued training and development, within the DHB and within the health and disability sector.
- 2.26 Procurement is well on the way to recognition as a profession, both in New Zealand and around the world. There is a growing understanding that there is benefit in developing and setting internationally agreed standards for competency, formalised training and qualification programmes, and common role definitions. Access to a professional body that regulates and monitors procurement competency standards and shares new developments through training opportunities will add to the value that knowledgeable and skilled procurement staff already provide to DHBs.
- 2.27 The Government Procurement Reform programme⁸ has set up the New Zealand Procurement Academy to facilitate this professionalism within the State sector. It offers subsidised access for State employees to study towards an internationally recognised professional qualification. It also offers non-assessed training on specific procurement-related topics.

⁸ The Government Procurement Reform programme, managed by the Ministry of Economic Development, was approved by Cabinet in May 2009. The programme has four key focuses: achieving cost savings; building procurement capability and capacity; enhancing New Zealand business participation; and improving governance, oversight, and accountability.

Decisions need to be recorded and clearly demonstrate their rationale

- 2.28 A major aspect of accountability, and of good risk management, is the ability to support the rationale for significant decisions. Having good records enables the significant decisions for each purchase and for the management of each contract to be recalled with accuracy, even some time after the procurement has occurred. Less reliance is placed on staff to remember what – and, in particular, why – decisions were made.
- 2.29 Good records protect against the risk of loss of critical personnel and the consequent loss of corporate knowledge of decision-making. Good records also provide evidence of decision-making should decisions be challenged for any reason.

Scope and quality of the purchase needs to be clear

- 2.30 The success of any procurement process is in obtaining the right supplies and services (the appropriate quantity and quality at the right time) for the right total cost to the DHB. Collectively, this represents value for money to the DHB. It is crucial that the DHB defines the supplies or services it needs as clearly as possible.
- 2.31 For simple purchases of familiar products, the definition may be a technical description of the supplies needed and the approximate quantity for the term of the contract. For more complex supplies and services, the definition may be more of a description of what needs to be achieved from the procurement (a functional description) or the performance parameters that the supplies or services will be required to achieve (a performance-oriented description), or some combination of these.
- 2.32 A clear definition of what is required is essential at the purchase planning stage. It will enable suppliers/providers to present proposals that best match the needs of the DHB. It provides the basis for accurately assessing whether (and how well) those proposals meet the DHB's needs. Clarity of definition reduces the time taken to clarify what is required to suppliers/providers before they submit their proposals, and also reduces the need to clarify how their proposals will meet the DHB's needs during the evaluation of proposals.
- 2.33 A clear definition of what is required forms the basis for determining the measures the DHB will use to determine whether the supplies or services delivered match its expectations. It determines the quality standards, quantity expectations, and timing of delivery that are needed to manage the delivery of the supplies or services.

Risk needs to be recognised and consciously managed

- 2.34 Risk needs to be consciously managed. Risk identification and assessment needs to be systematically carried out at an individual procurement level.
- 2.35 Risk needs to be considered in terms of the supplies or services being purchased. Such risks are usually reduced by clarifying the specification or performance requirements, selecting comprehensive evaluation criteria, or effecting appropriate contract monitoring requirements.
- 2.36 Managing process risk is also important. Does the process support the underlying principles of accountability, openness, value for money, lawfulness, fairness, and integrity? For example:
- Is the selected approach “fair” to the market?
 - Is there appropriate consideration of conflicts of interest, or the need to keep information confidential?
 - In a non-competitive process, how is the risk to value for money addressed?
 - What processes are in place to reduce the risk of unfair access to information about the DHB’s requirements?
- 2.37 Deliberate risk management is not a call to be overly risk averse. The key is to understand the risks involved and to have a balance between the risks and the benefit of addressing the risks. DHBs may choose to accept risk, but they must do so deliberately, conscious of the potential effect of doing so, rather than being unaware that a risk exists.

Part 3

Good or improving practices

- 3.1 In this Part, we discuss good or improving practices and provide some examples of these practices. We considered these aspects to be good or improving because they help DHBs to answer the critical questions about their procurement activity (see paragraph 1.3) and to understand whether they are spending money well.

Spending money on the right supplies and services

Access to good information on procurement

- 3.2 The key to knowing whether money is spent on the right supplies and services is knowing where money is being spent, on what supplies and services, in what volumes, and with which suppliers or providers. Some DHBs either have or are currently implementing good information systems to help them gather and report information about what is being purchased throughout the DHB.
- 3.3 Analysing this information can identify how the DHB is purchasing its supplies and services and whether there are opportunities to improve the way in which purchases are made or to alter what is purchased (see Example 1).

Example 1

MidCentral District Health Board's new contract management system

MidCentral DHB recognised that its fragmented contract registers were not enabling it to fully understand procurement throughout the DHB. The individual registers did not include the same information about the contracts, and were not able to provide complete information about all of the contracts on which the DHB was spending money.

MidCentral DHB also recognised that some purchasing was taking place without a formal contract. The DHB did not know the full extent of what was purchased in this manner, who the suppliers were, how frequently these supplies were needed or by whom, or how well the suppliers were responding to the DHB's needs.

As part of its procurement project, established in 2006 to enhance a range of aspects of procurement, MidCentral DHB began to assess its information needs and determine an appropriate solution.

In late 2008, the Board approved the purchase of a new contract management system. The new system will link with the DHB's financial management information system.

The DHB started using the new system in the first half of 2009.

Linking purchases to business requirements and reviewing existing contracts

- 3.4 The contribution of any function is measured against an organisation's strategic agenda: what that function is doing to help the organisation to achieve its strategic goals. It is essential that procurement is aligned with the DHB's strategic goals.

- 3.5 Purchases of health and disability services by the funder arms of DHBs are usually justified by strategies for addressing health issues in the population. Referring to national health and disability strategies or local population health needs' assessments establishes a clear rationale for purchasing the services.

Example 2

Canterbury District Health Board's business case template for funded services

Canterbury DHB's funder arm identifies new service requirements through an assessment of the health needs of its population and through health service development processes.

Each proposed new service or renewal of an existing service is prioritised for funding using a screening tool. DHB staff prepare a business case for proposed new services, or a streamlined business case for existing services, that meet current priorities for funding. The leadership team considers that business case when it makes decisions about how it will allocate funding. There is a standard template for all such business cases.

The business case is the formal documentation of how the services align with Canterbury DHB's strategic direction and priorities, and why funding for the service should be approved. The business case specifically requires the service to be linked to the current District Annual Plan, and also requires an assessment of how the service will remain relevant given the major trends in service development and health service planning models of care.

- 3.6 We identified some very good work being done to review existing funder contracts against strategic priorities. We understand that the review process may have been prompted by a restriction on the amount of "new" funding available to DHBs recently. In our view, however, the review process is good practice in any DHB that purchases health and disability services from external parties.

Example 3**Auckland District Health Board's contract review programme for funded services**

Auckland DHB's funder arm has recently implemented a major contract review process for all existing contracts for service delivery over which the DHB has discretion (which excludes some contracts, such as those directly funded by the Ministry of Health).

The DHB started by assessing service contracts that were due for renewal around 30 June 2010 (six months from the start of the review process). It assessed the link between the services and the DHB's – and the Minister's – current priorities. Based on that review, contracts were put in one of four categories.

The first category contained contracts for services that clearly aligned to Auckland DHB's or the Minister's priorities. These contracts were renewed for Auckland DHB's standard three-year term and scheduled for further review at their next renewal dates.

The second category contained contracts for services that did not align with current priorities. Steps were taken to advise the service providers about the review process and to put in place strategies to end the contracts.

The final two categories contained contracts for services that were still strategically aligned, but where further work was needed:

- In the first of these categories, the services were still in keeping with DHB priorities but the DHB needed to review them further to determine whether the method of delivery and the service specifications could be better aligned to priorities. These contracts were extended for 12 months to enable that review to take place.
- The second of these categories represented contracts for services that might not be delivering the benefits that were expected. These contracts were extended for six months and subject to a detailed review.

The service providers in all categories were told about the review process and timetable (including a meeting between providers and the Chair of Auckland DHB).

The DHB plans to review all remaining contracts early in 2010/11.

- 3.7 Unless purchased services are consistent with the DHB's health priorities, the DHB could achieve better outcomes by redirecting the money to other services that do align with its current priorities. Therefore, DHBs are progressively reviewing the services they are purchasing to determine whether the services meet current needs.

Collaborating with other DHBs and other organisations in procurement

- 3.8 Increasingly, DHBs are acting together to buy supplies and services. DHBs are also actively seeking to identify other DHBs and organisations with similar purchasing requirements, and looking for opportunities to work together to buy specific supplies or services. For example, the Lower North Island purchasing group has been formed that includes the New Zealand Defence Force and six DHBs.
- 3.9 Many government agencies are now including clauses in their purchasing contracts that enable other government organisations to opt in to the terms and

conditions. This is referred to as “syndication”. DHBs are also considering whether to enter syndicated contracts with other non-DHB organisations with similar purchasing requirements.

- 3.10 The advantages of collaborative and syndicated purchasing arrangements include:
- greater purchasing power, leading to better value for money than an individual DHB could secure on its own;
 - cheaper purchasing processes, because a number of parties share costs;
 - sharing purchasing knowledge between organisations, leading to improved purchasing practices for all participating organisations; and
 - standardising supplies for a number of DHBs, reducing the familiarisation time required for staff transferring between DHBs (and, in some cases, within individual DHBs).
- 3.11 DHBs have also entered into national contracts for supplies through the purchasing processes managed by District Health Boards New Zealand.⁹ HBL, set up after the Ministerial Review Group report (see paragraph 1.28), also aims to contribute to the effectiveness and efficiency of DHB purchasing by taking a national approach to some purchases based on a strategic assessment of benefit.
- 3.12 The Government Procurement Reform programme is also under way (see paragraph 2.27). This programme has started processes to make the most of the purchasing power of the collective State sector by negotiating all-of-government contracts. The State sector (excluding schools) comprises all government departments, Crown entities (including DHBs), and State-owned enterprises – in total, about 200 entities. The Ministry of Economic Development reports that, of these, 175 entities have expressed an interest in participating in one or more of the procurements under way.
- 3.13 At present, three procurements have resulted in all-of-government contracts – for single and multi-functional print devices, passenger vehicles, and office consumables (stationery). An additional procurement is in the last stages of negotiation for an all-of-government contract for computer desktops and laptops. These contracts have been established so that any State agency can elect to participate at any stage.
- 3.14 Collaborative purchasing can save money, not just by pooling volumes (allowing for better pricing from suppliers) but also by avoiding many of the administrative costs of the purchase process (though the individual agency will still be responsible for contract monitoring). It also enables organisations to share good practices.

⁹ District Health Boards New Zealand was formed in December 2000. It is a sector group DHBs can co-ordinate their activities through.

Employing procurement staff with a clinical background as well as procurement skills

- 3.15 We often hear from staff working in DHB procurement about the risk to the procurement process of subjective “clinical preference” overriding an objective assessment of value for money. Obviously, clinicians need to be involved in writing the description of clinical supplies (or services) that are required, because the supplies need to be fit for their clinical purposes. Clinicians are often also required to be included in the evaluation process.
- 3.16 The issue, often, is that procurement staff are not clinicians and do not understand the clinical issues that may arise for particular purchases. Similarly, clinical staff are not procurement professionals and do not understand the requirements of fair and transparent purchasing processes. One solution is to engage procurement staff with a clinical background.

Example 4 healthAlliance’s procurement staffing

In its procurement function, healthAlliance* prefers to employ staff who have a clinical background, so that they can more easily and effectively work with clinical professionals.

Staff with a clinical background can:

- better appreciate where clinical judgement may end and personal preferences begin;
- challenge clinicians if personal preferences appear to be overriding objective decision-making;
- challenge suppliers’ sales pitches;
- more easily identify non-price-related value in suppliers’ proposals;
- provide better targeted contract management and review (as they have a better understanding of operational issues); and
- develop better relationships with clinical customers, as they can “speak the same language”.

healthAlliance provides its staff with training in procurement if they do not already possess those skills.

* healthAlliance is a subsidiary of Counties Manukau DHB and Waitemata DHB. It provides shared services arrangements for both DHBs, including most provider and corporate purchasing.

Mechanisms to evaluate new products or technologies

- 3.17 Another way in which clinical preferences can be made less subjective is to establish clinical product evaluation committees. These committees are set up to assess any new product or technology promoted by a supplier that is not currently used by the DHB. They usually have a common core membership, with additional staff representing those specialist clinical areas most directly affected by the new supplies.

- 3.18 In a manner similar to a tender evaluation, the committee's purpose is to identify the significant aspects of the new supplies to determine whether they are fit for their intended purposes. These are then compared with any similar supplies that may be replaced by the new supplies to determine the relative merits of the new supplies. The product evaluation committee then either endorses or rejects the supplies for use in the DHB. The decision is passed on to procurement staff to assess whether a purchase arrangement is needed for the supplies and how this might be best incorporated into current purchasing arrangements (or whether new purchasing arrangements are required).
- 3.19 The benefit of a product evaluation committee is in the clinical assessment of all innovations before any purchase process begins. This makes it clear in any subsequent purchase that the supplies will be clinically acceptable.
- 3.20 It also provides a defined path for suppliers to introduce new products or technologies to the DHB, avoiding concerns about suppliers approaching individual staff members or circumventing current contractual arrangements.
- 3.21 National product evaluation may be a mechanism that HBL chooses to use to help find efficiencies in procurement for all DHBs.

Making the most of procurement staff

- 3.22 As noted in Part 2, experienced and capable procurement people are scarce, and in demand from both the public and private sectors. Instead of recruiting new procurement professionals, some DHBs are instead investing in developing their own procurement people. This investment has benefits for both the DHB (more knowledgeable and better skilled staff) and for the staff (development of their professional skills and a sense of being valued by the DHB).

Example 5

Auckland District Health Board's Chartered Institute of Purchasing and Supply training

Auckland DHB has enabled its procurement staff to qualify as members of the Chartered Institute of Purchasing and Supply (CIPS). CIPS is an international organisation, originally launched in the United Kingdom but with branches worldwide, providing a wide range of services to the purchasing and supply profession.

The services include professional training courses, access to a wide range of resources (including an online library and guidance on current practice from specialist consultants), and the latest news and updates in purchasing and supply matters.

CIPS offers internationally recognised professional qualifications over six levels, from diploma through to degree level (which results in membership and the designation MCIPS).

Example 6**Nelson Marlborough District Health Board's PRINCE2 training**

Nelson Marlborough DHB has begun a programme to put its funder arm staff through the PRINCE2 project management qualification. PRINCE2 is a project management methodology developed by the Office of Government Commerce in the United Kingdom.

Nelson Marlborough DHB identified a need to develop the skills of its funder arm staff after an external review of project management practices. The project management principles, themes, and processes of PRINCE2 are applicable to procurement activity (especially the risk management aspects).

The additional training will help the funder arm staff to understand the benefits of a structured and well-documented approach to projects (including procurement).

Sharing staff knowledge and experience

- 3.23 Because knowledgeable and skilled procurement people are scarce, it makes sense that DHBs make the most of the knowledgeable and skilled procurement staff they have, especially where procurement is carried out in a number of places within the DHB.

Example 7**Canterbury District Health Board's Supply Department**

Canterbury DHB's Supply Chain Enhancement Project (begun in 2007) is a strategic initiative to "professionalise" the DHB's procurement approach to enable efficiencies and save money to put into the clinical side of the DHB.

Part of this project saw Canterbury DHB increase the number of, and increase the training and support of, specialist staff in purchasing and contract management/implementation in the Supply Department.

Since 2007, the Supply Department has been increasingly seen as a source of expertise and advice on procurement. The Supply Department provides advice and expertise to help other departments with their purchasing or contract management issues. It operates almost like a central helpdesk for any other procuring area within the DHB.

This is not a centralisation of all procurement with the Supply Department, but a source of good practice and interpretation of the DHB's procurement policy and procedures.

Purchasing supplies and services in the right way**Planning the procurement programme**

- 3.24 Establishing a programme for purchasing activity that needs to occur during the year helps to ensure that the purchasing processes are well timed. Following an annual programme for purchasing can eliminate gaps between the end of one contract and the start of the next. It also helps the DHB to manage the workload of staff directly involved in purchasing and other staff who might be involved in a purchase (such as clinicians).

Example 8 healthAlliance's annual procurement work programme

healthAlliance prepares a formal annual work programme of purchasing requirements. It uses the programme for purchasing corporate and hospital supplies and services (provider arm contracts), but not for services that its shareholding DHBs fund (funder arm contracts).

The programme is based on information about upcoming end dates of existing contracts from the contracts register, and healthAlliance's knowledge of the likely approach to the purchase and time frames required for completing the purchase before the contract's end date.

The programme provides an advance indication of the purchasing workload in each purchasing area within healthAlliance, and what input is needed from staff involved in delivering hospital services.

healthAlliance reports that the benefits of planning its annual work programme include:

- reducing the number of ad hoc projects;
- awareness of the programme within the operational areas of the DHB;
- ownership by the DHB; and
- clarity of roles and responsibilities for all parties expected to contribute to the work programme.

- 3.25 In our view, an annual programme for the purchasing activity that has to occur is a simple and essential component of well-managed purchasing. However, the effectiveness of an annual programme can be undermined by a lack of engagement from the wider DHB staff required to contribute to the purchasing process. Therefore, it is essential to consult and obtain senior management's agreement to ensure that the programme is acceptable to the wider DHB business.

Providing clear guidance to staff through purchasing policy and procedures

- 3.26 We have noted a general improvement in the standard of policies and procedures to guide purchasing in the three years that we have been looking into procurement. Policies have been lifted from mere financial thresholds for tendering to statements about the overall purchasing philosophy of the DHB and its expectations for the way in which purchasing is carried out.
- 3.27 Policies now include:
- direction on the financial thresholds for tendering;
 - a preference for competitive purchasing;
 - an expectation of ethical behaviours and legal compliance in purchasing activity;
 - direction on how the concept of sustainability is to be given effect in purchasing; and
 - requirements for confidentiality and good record-keeping.

- 3.28 Procedural guidance identifies purchase methods and when they may be appropriate. It also sets out evaluation approaches, and detailed requirements for giving effect to the policy (such as procedures for identifying conflicts of interest).

Sharing good policy and procedures documents

- 3.29 With 20 DHBs, there are definite efficiencies to be gained from sharing procurement policies and procedures that are consistent with good practice. Each DHB is then able to tailor the good practice policies and procedures to its circumstances (including purchasing and contract management structures and information systems).
- 3.30 We have noted two ways in which DHBs share policies and procedures:
- collaborative development of policies or procedures, which are then applied in a number of DHBs; and
 - transfer or purchase of policies or procedures that have been recognised as good practice.

Example 9

Regional contracting guidelines developed for Auckland-based district health boards

The three Auckland-based DHBs (Auckland, Counties Manukau, and Waitemata) have collaborated with the Northern DHB Support Agency (NDSA) to produce regional contracting guidelines.

The guidelines were prepared for use predominantly by the funder arms of each of the DHBs. The guidelines provide clear guidance to funder arm staff purchasing services from NGOs. The guidelines provide for consistent practices and forms for funder arm procurement in the three DHBs.

The guidelines mean that any supplier that is providing services to more than one of the three DHBs knows that they will be treated consistently and will receive contract documents that are consistent, regardless of which of the three DHBs they provide services to.

Example 10

Hawke's Bay District Health Board's Procurement Toolkit

We noted that at least four DHBs have formally adopted Hawke's Bay DHB's comprehensive Procurement Toolkit and have tailored, or are tailoring, it to their organisation.

Adopting a similar entity's policy and procedures is an effective way of reducing the administrative time in preparing policy and procedure documents, particularly where those policy and procedure documents have been externally reviewed and rated as complying with good practice. Hawke's Bay DHB recognises this potential for administrative efficiency and has therefore been active in sharing its Procurement Toolkit.

Hawke's Bay DHB is continuously improving the documentation and templates to reflect changes in good practice, and circulates those updates to DHBs that have adopted the Procurement Toolkit. It reports that this process has been positive for all DHBs concerned – including Hawke's Bay DHB – as improvements and information flows both ways to inform changes and improvements for the wider group of DHBs.

- 3.31 We also note the work of the Government Procurement Reform programme in producing tools and templates available to all procurement practitioners, and the ongoing programme of standard document development. These tools, templates, and standard documents can also reduce the amount of time that individual DHBs spend on developing guidance for their procurement staff.

Documenting agreements

- 3.32 DHBs use appropriate forms of contract for almost all of their purchases. There is evidence that contract documents for complex purchases have been subject to legal review before the documents were completed.
- 3.33 Well-documented contracts for purchases provide certainty about what was agreed to be purchased (quantity, quality, and price), how it was to be delivered and paid for, and the mechanisms that are available should anything go wrong with the purchase delivery.
- 3.34 We noted the use of standard Sector Services¹⁰ (previously HealthPAC) contract documents for most purchases of services from NGOs. These standard contracts establish consistency between DHBs for organisations providing services to more than one DHB.
- 3.35 However, standard documents cannot be used without careful consideration of whether they are an appropriate standard for the circumstances and without being tailored accordingly.
- 3.36 The Government Procurement Reform programme includes developing standard contract documents for possible use throughout the whole of the State sector. To date, two standard contract documents have been written for low-value, low-risk purchases (one for supplies and the other for services). The draft documents were circulated for consultation before being finalised and made available on the Ministry of Economic Development's website.

Recognising their limitations

- 3.37 Many DHBs acknowledge that managing large building projects is not a core skill for their employees. Therefore, when they are planning for a large building redevelopment project, they employ consultants who have those skills either to support the DHB's own staff through the process or to provide specialist skills and experience.
- 3.38 These external consultants are usually qualified project management professionals. Part of their knowledge and experience in project management is in purchasing the services necessary to complete the project and in managing the

¹⁰ Sector Services is a business unit of the Ministry of Health, providing payment, agreement, and compliance services to funders such as DHBs.

delivery of the project in keeping with the contracts for purchase of services. As a result, we noted that large building projects are usually managed well.

Example 11

Lakes District Health Board's "Lakes Health Service Improvement Project"

In 2006, Lakes DHB began a project to enable better service delivery at its Rotorua and Taupo hospitals.

The business case for the project identified that the Rotorua facilities needed to be significantly redeveloped to support Rotorua's growing health needs. The business case also identified a need to reconfigure some services at Taupo Hospital. Both redevelopments involved constructing new buildings and refurbishing existing buildings for different uses.

Lakes DHB identified early that redevelopment projects were not its usual business. After first receiving approval of its business case, Lakes DHB sought help in 2008 – through a competitive purchasing process – from an external project manager to complete the building project. The project manager reports to a designated Lakes DHB staff member (the Project Director).

Therefore, Lakes DHB has a professional project manager to ensure that the building works are completed in keeping with the objectives of the business plan (including costs and timetable). It also has an opportunity for its staff to enhance their skills in project management by learning from the external project manager.

Identifying and managing informal spending

- 3.39 To understand the full picture of procurement within DHBs, it is important to understand not only those purchases that are subject to formal contracts but also the details of informal spending to determine whether this spending is managed efficiently. One means of obtaining information on informal spending is to analyse the accounting system that processes payments against the contract information system.

Example 12

healthAlliance's monitoring and management of informal spending

healthAlliance has established a catalogue of supplies for which it has negotiated purchase arrangements with various suppliers. Any DHB staff member with delegated authority to purchase supplies for the DHB can access this catalogue. When a staff member requires supplies, they raise a purchase order using the information on supplies and suppliers from the catalogue. If the supplies they require are not listed in the catalogue, they can contact healthAlliance to discuss the need for the supplies and whether new purchasing arrangements need to be established for those supplies.

healthAlliance also processes payments for supplies on behalf of its shareholding DHBs. Staff who process payments are able to compare the invoices received for payment with particular supplies described in the catalogue to check pricing and other details. When an invoice is received from a new supplier or for a product not contained in the catalogue, healthAlliance contacts the originator of the purchase to find out why the catalogue suppliers or supplies were not used.

In this way, healthAlliance is able to monitor and manage informal spending by:

- reducing variation and increasing standardisation of supplies used in each DHB;
- identifying "spend areas" for future procurements; and
- deriving efficiencies from purchasing by controlling the catalogue.

Getting the supplies and services you thought you were buying

Providing tools to help contract managers

- 3.40 We know, from the self-assessment data provided by DHBs in 2007/08, that they have large numbers of contracts (the smallest DHB had 70 contracts worth about \$50 million; the largest had more than 2000 contracts worth about \$700 million). Managing this volume of contracts needs to be tailored to the risk and scale of the contracts. DHBs have different ways of determining the effort required to appropriately manage the risks and scale of their contracts.

Example 13

Contract management tool linking risk to response

We noted some good work under way by one DHB to develop a tool to help contract managers understand the link between contract risk and the appropriate contract monitoring response.

The DHB expects the tool to enable contract managers to identify the risk components of their contracts, and attach a score to the risk. This risk score, together with an assessment of the value of contracts, will be used to classify contracts into categories to guide the level of monitoring required and the appropriate mechanisms for monitoring.

The mechanisms will include reactive monitoring after an issue is identified, low-level proactive monitoring after self-reporting by the supplier, and full proactive monitoring at a transaction level and of the overall supplier relationship.

The tool is in its early stages of development. We have not identified the DHB concerned, to allow it time to finish developing the tool before sharing the results with the sector.

Using independent parties to help assess the delivery of services

- 3.41 A large number of DHBs engage external parties to review the processes that providers have in place for delivering services according to the specifications in their contracts with the DHBs. This is an efficient way for DHBs to review a number of contracts for the same or similar services, particularly where they do not have the capacity to perform the review work themselves.
- 3.42 Review methodologies can be developed and agreed, and a schedule prepared to ensure that the reviews target those providers whose performance may not be known to the DHBs (such as new providers delivering services for the first time) or concerns raised about aspects of performance.

Example 14**Canterbury District Health Board's independent review of providers**

Canterbury DHB's funder arm engages several different independent auditors to carry out periodic reviews of the providers of its services.

Canterbury DHB agrees a programme of reviews that is based on a risk assessment of the providers and their service delivery performance history. The programme is amended for new information about increases or reductions in concerns about performance (from additional complaints or results of previous periodic reviews).

The scope and methodology for the reviews, and the responsibility for follow-up action, has been clearly agreed between the independent auditors and Canterbury DHB.

Canterbury DHB is currently reassessing the scope of these reviews to ensure that they meet the DHB's objectives for monitoring the service delivery performance of providers.

- 3.43 In such review arrangements, DHBs need to be clear about the aspects of service delivery performance that need to be covered and who is responsible for following up any review findings.

Knowing whether enough attention is being paid to procurement

Getting independent oversight for significant purchases

- 3.44 Some DHBs recognise the benefit of obtaining independent confirmation that large, important, or complex purchases are completed in keeping with good practice. This independent oversight is sought more frequently where such purchases do not occur regularly, when the DHB is amending its purchasing process, or when it is using a particular purchase or evaluation method for the first time.

Example 15**Counties Manukau District Health Board's independent review of large building project procurements**

Counties Manukau DHB has engaged an independent party to oversee the application of its policies and procedures, and good purchasing practice, for the purchase of services associated with its large building project programme.

The independent party provides reports to the particular governing body responsible for overseeing the projects (such as a steering group), but works alongside DHB staff and consultants to ensure that any concerns raised are addressed before they adversely affect the purchasing process.

Example 16**Waikato District Health Board's "Service and Campus Redevelopment" project management assurance**

In 2004, Waikato DHB embarked on a large-scale development of its hospitals in Thames and Hamilton. Waikato DHB engaged a "probity auditor" to provide independent assurance to senior management and the Board that:

- procurement processes for the selection of consultants and contractors were in keeping with good practice and appropriately addressed probity risks; and
- the project management processes conformed to good practice, minimising the risk of failure because of poor management practice or weak processes. This included assurance that key project risks had been identified, action had been taken to reduce and manage them, and they had been reported to the Campus Redevelopment Committee.

The services secured by Waikato DHB provide a level of comfort to senior management and the Board about both the purchase and contract management aspects of this major redevelopment project. As the project is not yet complete, this assurance work is continuing.

- 3.45 The benefits from such reviews do not rest solely with the additional comfort to senior management and the Board that the processes were sound. Many DHBs express appreciation of the learning passed on to their procurement staff from being exposed to independent oversight. This oversight role raises staff awareness of the risks to the underlying principles of purchasing (particularly fairness, value for money, and integrity) that they may have previously and unwittingly accepted.

Paying appropriate attention to their own practices

- 3.46 In recent years, we have seen DHBs paying an increasing amount of attention to procurement matters. In some DHBs, procurement is becoming a regular agenda item on the internal audit programme.
- 3.47 In some DHBs, this attention has started because of concern about a particular procurement that was not managed well. In others, it has arisen from a need to understand where the DHB's money was spent and whether there were efficiencies to be gained from improving practices.
- 3.48 Regardless of the reason for this additional attention, in our view it is only proper that DHBs focus attention on reviewing their procurement practices. It is a means of determining whether the purchases they are making are fit for purpose and represent good value for money. It is also a means of ensuring that the processes they use are in keeping with the underlying principles of procurement.

Part 4

What needs to improve

- 4.1 As we carried out our work in the last three years, we came across examples of practices that raised questions about whether particular DHBs got value for money or unwittingly accepted risks during the purchasing process, or both.
- 4.2 In this Part, we set out some examples of the practices that DHBs consistently needed to improve before they would be able to answer the key questions about their procurement activity (see paragraph 1.3). We discuss the risks that DHBs are accepting (without realising it in many instances) and the effect on the underlying principles of procurement, especially value for money and fairness.
- 4.3 The matters discussed are based on actual practices reviewed during our work. We have chosen not to identify the DHBs involved.

Improve the focus on purchasing the right supplies and services

Connect all the procurement-related information systems

- 4.4 Some DHBs are still unable to provide complete information on all the contracts they have.
- 4.5 Most often, the information is not available in a format that can easily be consolidated with information from other procurement activity. This is usually because:
- it is a handwritten list;
 - it is out of date (because it requires manual updating);
 - staff carrying out “pockets” of procurement do not keep a register of contracts;¹¹ or
 - formal contracts have not been put in place to cover the procurement activity.
- 4.6 As we have discussed previously, incomplete procurement information:
- inhibits the ability of the DHB to take a strategic and forward-looking approach to procurement;
 - prevents appropriate risk management processes from being set up; and
 - increases the risk that the DHB is not consistently getting value for money from its procurement activity.

11 Some staff in DHBs regularly spend money on supplies or services, even though their role is not solely focused on procurement (for example, some theatre staff are responsible for buying theatre supplies but are not members of the provider arm's procurement team).

Identify and manage informal spending

- 4.7 We have previously referred to an agency supporting two DHBs that has put in place appropriate controls to identify and manage informal spending. However, most DHBs do not have such controls in place.

Example 17

Extent of unmanaged informal spending

At one DHB, we examined a list from the payments system of “active” suppliers (those that were paid during the financial year to 30 June 2009) and compared it with the register of contracts that the DHB provided to us.

There were more than 2000 active suppliers, but only 900 contracts in place. One explanation for the difference was that payments to reimburse employees for expenses were included as “suppliers” in the payment system but not recorded on the contracts register.

Although this explained some of the difference, the remainder was informal spending.

- 4.8 Other DHBs told us that they did not have enough information to determine the size and scope of informal spending and whether the DHB was getting value for money from this spending. Informal spending is not necessarily a problem. There may well be circumstances in which a purchase does not warrant a formal contract and a purchase order is enough evidence of the purchase. However, it is of concern that DHBs did not have enough information to gauge the size and scope of this type of spending.

Reduce reliance on existing staff as trainers

- 4.9 When discussing the emphasis of procurement training with DHBs, we noted that a number of DHBs rely on their existing staff to “buddy” with new staff to train them in how procurement is done in that particular DHB. There are some benefits associated with this approach, particularly where the staff doing the training are recognised as having good skills and experience.
- 4.10 However, the staff who are training new staff in this way have not necessarily had any formal procurement training themselves. They also learned how procurement was done from existing staff when they started. The risk in this reliance on internal training is that existing staff pass on misunderstandings and bad habits to new staff.
- 4.11 We suggest an appropriate balance between “on the job” learning and formal training from recognised procurement professionals. This will increase the level of understanding of procurement matters and the practical application of procurement practices.

Break down the “pockets” of purchasing activity

- 4.12 DHB purchasing activities have, historically, been structured in a broadly similar way. Purchasing is generally dispersed widely within the DHBs, but most purchasing is carried out by provider, funder, and facilities sections. The provider section usually buys supplies and services for corporate purposes, as well as for hospital purposes. Purchasing activity can also be carried out by smaller groups, such as staff within the DHB’s pharmacy, information technology team, and human resources team.
- 4.13 We were concerned that each section within each DHB appeared to have been acting quite independently. There was little sharing of purchasing practices between these sections.
- 4.14 We noted several instances where staff responsible for purchasing who were not in the funder arm, or the purchasing or supply department of the provider arm, did not have enough knowledge about DHB purchasing policies and the risks associated with purchasing. In all of these instances, the DHB had staff with appropriate purchasing knowledge and capability in their main purchasing sections, but that knowledge and capability was not shared.
- 4.15 All staff involved in procurement matters should understand the risks and issues associated with procurement and have a good knowledge of their DHB’s procurement policy and procedures. Where this is not feasible, because the staff are infrequently involved in procurement, they should at least have access to support and advice about procurement matters or pass the procurement activity to people who are skilled and experienced. This is good risk management practice.

Plan succession

- 4.16 Not all staff involved in purchasing activity are qualified and/or experienced in purchasing processes. Staff attrition in purchasing can significantly affect the expertise available to the DHB. Some DHBs told us that they are having difficulty filling vacant purchasing positions, and that staff turnover had been high. This poses a significant risk to effective and efficient purchasing.
- 4.17 Even if the other components of a good purchasing system are present, a lack of available knowledge and skills generally means that people can make decisions during the purchasing process without fully understanding the risks of those decisions.
- 4.18 To reduce the risk of staff turnover and the consequent loss of knowledge, DHBs should consider the ways in which they could plan for succession to replace key personnel, and retain corporate knowledge in the form of good procurement documentation.

Make the best use of available resources internally and throughout the sector

- 4.19 A common comment made to us was “We could do more with more staff.” This was particularly relevant to the amount and quality of contract management carried out. If staff are using efficient processes, matching their effort to the level of acceptable risk, collaborating with other entities, and taking advantage of regional and national purchasing opportunities where appropriate, more time may be released to do more. However, eventually DHBs will need to consider whether staffing levels are appropriate to cover the workload required by the procurement risks they face.

Improve the way supplies and services are purchased

Improve policy and guidance

- 4.20 Although we have noted significant improvements in the last three years in the standard of policies and procedures available to staff, our review of the procurement practices for individual contracts has identified some aspects where further guidance and/or training is warranted, particularly in risk identification and management.
- 4.21 We noted an instance where a DHB had no standard documents for competitive purchasing processes, meaning that new documents were created for each purchase. Not only did this increase the administrative time in preparing new documents, it introduced inconsistency in the requirements and purchasing process between procurements.
- 4.22 This same DHB was also often left in the position of accepting a supplier’s terms and conditions of contract because it had no standard terms and conditions of contract to offer. This led to an excess of non-standard conditions, making it almost impossible to administer contracts to a standard that consistently reflected the DHB’s policies and principles.
- 4.23 In Examples 9 and 10, we noted DHBs that actively shared policy and procedural guidance. We suggest that sharing could extend to standard templates for common procurement documents. This would enable smaller DHBs or those without access to skilled and experienced procurement staff to adapt these templates for their own use rather than spending time creating procurement documents for themselves.

Provide clarity on policy coverage

- 4.24 Some staff carrying out procurement in smaller groups (such as the pharmacy or surgical theatres) did not know about the DHB's procurement policy or that it applied to their activity. Some were working to their own "policy" standards, which were not necessarily consistent with the DHB policy and sometimes were not documented.
- 4.25 DHBs need to ensure that they have a clear understanding of where procurement activity is happening and what is being procured. In doing so, they should also ensure that all staff involved in procurement are aware of, and applying, the DHB's approved procurement policy.

Plan better

- 4.26 Many of the matters that need to improve relate to the apparent lack of systematic planning for procurement activity, at both the overall programme level and at the individual purchase level.
- 4.27 In many purchases we reviewed, DHBs had not allowed enough time to complete the purchasing process before the end date of the current arrangements. It was not always clear whether the planning started too late for the purchasing process to be completed or the process took longer to complete than planned.
- 4.28 In some cases, contracts were "rolled over" with the current supplier. For interim arrangements like this, the DHB may have to accept unfavourable terms and conditions, and may not be able to appropriately demonstrate value for money.

Example 18

Poor planning for a purchase of continuously required supplies

We reviewed a contract for consumable supplies for a DHB's surgical theatres. The contract was extended in 2007 and 2008.

The documentation on file recommending the 2008 extension noted that the current supplier had increased its prices at the end of its existing contract term, and that the DHB was aware of other potential suppliers.

The documentation also stated that the DHB had intended to test the market for a competitive purchase, but there was not enough time to do this because the contract had already expired.

The contract was later extended for six months, at increased prices, to give the DHB enough time to complete a competitive purchase for the supplies.

- 4.29 DHBs face several risks if a contract ends before a new contract begins (for a continuing supply or service):
- The DHB might not be able to source the supplies or services needed.
 - The terms and conditions for purchases covering the “gap” between contracts may be unfavourable to the DHB.
 - If performance issues arise, the DHB could have limited ability to correct them.
 - The DHB might not be able to enforce service delivery standards and reporting requirements.
- 4.30 Many individual purchases made by DHBs did not have evidence of adequate planning. A lack of planning for a purchase can lead to the DHB purchasing supplies and services that do not fully meet its requirements, and in a manner that exposes the DHB to challenges about the openness, fairness, or integrity of the purchasing process.

Apply a purchasing approach suited to the purchase

- 4.31 The selection of a purchasing approach needs to consider:
- the overall principles underpinning purchasing activity – accountability, openness, value for money, lawfulness, fairness, and integrity;
 - the strategic view of procurement that the DHB has developed; and
 - the scale and nature of the individual purchase and the risks involved.
- 4.32 DHBs’ policies usually specify a preference for competitive purchasing. However, their policies acknowledge that a competitive approach is not always appropriate for:
- inexpensive purchases;
 - particular services (for example, services funded by the DHB where the relationship with the supplier is important, or where specialist advice is being sought);
 - particular market conditions (for example, where there is only one supplier or provider); and
 - the delivery of a particular service (for example, where the service is targeted to a specific population, which limits the number of providers able to provide the service).
- 4.33 An open competitive purchasing approach is an effective way of showing that the purchase represents value for money. Two or more parties compete to deliver the supplies or services. Managed appropriately, a competitive approach provides for an open and fair purchasing process that represents value for money, and an outcome for which the DHB can be held accountable.

- 4.34 Where a competitive purchasing approach is not seen as an appropriate approach for the circumstances of a particular purchase, DHB policies usually require justification of the purchasing approach to be adopted. Most DHBs have some guidance about the circumstances in which a departure may be acceptable. The justification should consider the overall principles underpinning purchasing activity: accountability, openness, value for money, lawfulness, fairness, and integrity.
- 4.35 There are also additional requirements that DHBs need to satisfy to ensure that a non-competitive purchasing approach remains open and fair, and delivers value for money. DHBs could be at risk of challenge from suppliers or providers that have not had an opportunity to submit a competitive offer for the supplies or services that were purchased by direct negotiation with a single supplier or provider.
- 4.36 Many of the individual purchases that we reviewed were purchased using a non-competitive approach. Some of these were justified from a strategic procurement perspective, because they were contracts for which there was no effective market or for which the relationship with the supplier was a critical element in the effective delivery of the services. However, for many others, we noted no appropriate justification for using a non-competitive approach.
- 4.37 We were concerned at the lack of information available about how these non-competitive purchases represented value for money to the DHBs.

Example 19

A non-competitive purchase without apparent justification

We reviewed a contract for medical supplies. The contract was originally awarded in late 2002, after what appears to have been a competitive purchasing process. The contract was for two years, with a “right of renewal” for a further two years if the supplier’s performance was satisfactory.

A memorandum was prepared for the DHB’s Board in 2004 that recommended exercising the two-year right of renewal. The memorandum indicated that there were other potential suppliers in the market with possibly better pricing than the current supplier’s. The memorandum referred to an intention to conduct a competitive purchasing process for these supplies in 2005 to ensure that any new supply arrangement was in place before the end of the two-year right of renewal term.

The contract has since been extended twice, each for a one-year period. We found no documented justification for the further use of a non-competitive purchasing approach. Nor did we find any evidence that the continued extension of the contract represented value for money for the DHB.

The latest contract extension expired on 31 October 2008. Although we found no further contract extensions on file, the DHB was continuing to purchase these supplies from the existing supplier.

Example 20**Weak justification for a non-competitive purchasing approach**

We reviewed a contract for delivering training services. The contract was awarded in 2008, using a non-competitive purchasing approach. The justification for a non-competitive purchase was that there was a “monopolistic market”, meaning that only one supplier was capable of providing the services.

However, there were handwritten notes in the file about informal market approaches to other suppliers before the preferred provider was chosen. These notes clearly indicated that there were other suppliers in the market. The DHB could have used a competitive purchasing approach, to ensure that the contract for training services represented value for money.

Example 21**Querying justification for a non-competitive purchasing approach within the DHB**

We reviewed a contract for office supplies that was originally awarded in 2003 for one year. The contract was between the supplier and an entity representing a number of DHBs. It was unclear from the file whether the original contract was awarded using a competitive purchasing approach. However, the file contained evidence that the contract had been extended in 2004 for one year, with two one-year “rights of renewal”. The first right of renewal in 2005 was taken up. The entity representing the DHBs was disbanded when the second right of renewal was due in 2006.

Each of the participating DHBs individually decided how to continue purchasing their office supplies. One DHB chose to directly negotiate a contract with the current supplier for three years, with a right of renewal for another two years. The paper justifying the non-competitive approach identified that the current supplier had said that it was unable to “hold prices” if the DHB chose to break away from the existing contract arrangements, but that it would “hold and improve on prices” if the current supplier was awarded a contract for a longer term. The DHB also identified that the current supplier had “demonstrated a willingness to be a proactive partner ... by providing ideas and extensive reports displaying how we can best reach our goals”. No other rationale was given for choosing a non-competitive purchasing approach over a competitive purchasing approach.

The reasons noted for using a non-competitive approach were not in keeping with the DHB’s purchasing policy. They were also, in our view, insufficient for a simple commodity purchase in a highly competitive market. The DHB might have secured a contract of equal or better value for money if it had used a competitive approach.

The approving authority that signed the “Request for Contract Sign-off” included a handwritten note that read “Tender? Dispensation again”. This indicates some question in the approver’s mind about the justification for extending the contract rather than entering into a competitive purchasing process for the supplies. There was no documentation in the file to indicate that the issue raised by the approving authority had been satisfactorily resolved.

- 4.38 In the examples above, the DHBs did not provide enough evidence that the use of a non-competitive approach was fair, or that the resulting purchase represented value for money.

Manage purchasing risk

- 4.39 In a large number of the contracts that we reviewed, procurement risks were not appropriately considered either at the planning stage or during the purchasing process. In particular, the sorts of risks that were not appropriately considered included:
- conflicts of interest;
 - managing communication with suppliers/providers; and
 - evaluating competitive tenders.
- 4.40 We appreciate that conflicts of interest have been prominent in the health sector for some time, and that DHBs have taken steps to properly identify and manage conflicts of interest at the Board level. Many DHBs are also amending conflict of interest processes for staff. We have noted some improvements in both identifying and managing conflicts of interest. However, there is still room for DHBs to improve.
- 4.41 We were concerned about the lack of evidence in purchasing files that conflicts of interest had been considered, such as specific declarations or notes of discussions about conflicts of interest. All DHB purchasing sections (that is, corporate, provider, and funder sections) lacked such information, for both competitive and non-competitive purchases.
- 4.42 At best, this means that the potential for conflicts of interest had been appropriately discussed and managed throughout the process, but not recorded. However, our work in several DHBs indicates that it is more likely that DHBs were failing to appropriately identify, assess, or manage conflicts of interest during purchasing processes.
- 4.43 Where DHBs included documentation in the purchasing files, it was not always clear whether the discussion about conflicts of interest covered all of the staff and external advisors involved in planning, managing, and approving the purchase. In many instances, the conflict of interest declarations that were included in the files were only for members of the team responsible for evaluating the offers. In other cases, the declarations covered only those members of the evaluation team who were not DHB staff.
- 4.44 During all stages of the purchasing process, actual or perceived conflicts of interest could have a significant effect on the fairness and integrity of the purchasing process. Therefore, it is important to ask all parties involved in the purchase to identify and assess conflicts of interest.

- 4.45 For the few purchases where processes were appropriately applied and conflicts of interest were identified, we saw little evidence that the DHBs had assessed the implications of the conflict of interest. It was unclear whether DHBs took any action to reduce the effect of the conflict to ensure that the management of the purchase remained fair and unbiased.

Example 22

Where a conflict of interest process could be widened

We reviewed a contract where the DHB used its existing supplier of advisory services to help it draft the specification of services to be included in an invitation to tender document. The same supplier was then allowed to tender for the contract.

This creates a significant risk to the fairness of the purchase process, because the supplier had the opportunity to draft the specification to suit its product or mode of operation. In addition, the supplier also had more detailed information about the intended purchase, and had that information earlier, than other potential suppliers.

Conflict of interest declarations had been documented by all of the tender evaluation team members. However, in this case, it was not clear whether the DHB had considered the conflict of interest issues for the staff and advisors involved in preparing the tender documents. In addition, it was not clear whether, and how, the DHB had managed the risks of using its current supplier to draft the specification of services.

The existing supplier was later chosen as the preferred supplier of these services.

Example 23

Poor management of declared conflicts of interest

We reviewed a contract for cleaning services that were competitively purchased in 2006/07. We reviewed the conflict of interest declarations in the purchasing file.

Four of the eight members of the evaluation team who completed conflict of interest declarations declared that they had received hospitality from the companies that submitted tenders. Three of the four received hospitality from the organisation that was eventually successful in securing the contract for the cleaning services.

There was no evidence in the file describing how the declared conflicts were assessed, managed, mitigated, or otherwise addressed.

The information on the file indicated that there were 12 members of the evaluation team. This means either that four members did not complete a conflict of interest declaration or that these declarations were completed but not included on the purchasing file.

- 4.46 We noted examples where communications had been poorly managed:
- Information had been provided to some tenderers but not others.
 - Invitations to visit the premises of individual tenderers were accepted without ensuring that the premises of all tenderers were visited.
 - Individual tenderers had been allowed to visit the DHB and discuss aspects of the tender, but the DHB had not given the same opportunity to all tenderers.

Example 24**Poor practice in responding to communication and offers from potential suppliers/providers**

In some purchases we reviewed, a party responding to the invitation to submit a competitive offer had asked a question of the DHB. The DHB provided the answer to only that party. This meant that others intending to compete for the purchase were not given the same information. The DHB ran the risk that the other parties were unable to compete on the same basis as the questioner, and could challenge the purchasing process based on that unfair advantage.

We also reviewed a purchase in which one party submitting a tender offered to show DHB representatives around its operating base. Such a site visit was not a requirement for the purchase. The DHB accepted the offer but did not advise other parties who had submitted tenders that the DHB was now prepared to make site visits.

Therefore, the DHB gave one party a potential advantage – to give a more thorough explanation of their operation than would have been possible in writing. Furthermore, that party was able to make a personal connection with the DHB's representatives who would be selecting the successful tender.

In this purchase, another party became aware that the site visit had occurred and complained to the DHB about the unfair process. The purchasing process was delayed until the DHB's representatives visited the complainant's base of operations.

- 4.47 In Example 24, the management of the communications might have adversely affected the openness, fairness, and integrity of the purchasing process. This increased the risk that unsuccessful suppliers and providers might challenge the purchasing decision in some way, whether through legal, political, or other accountability processes.
- 4.48 In many of the competitive purchases we reviewed, there was little or no record of:
- the evaluation process, in either an evaluation plan or otherwise;
 - the evaluation's results, in either detailed "scoring sheets" or another form; or
 - a recommendation for awarding the contract, based on the evaluation completed.
- 4.49 In these contracts, we were unable to determine whether the evaluation was conducted in a fair and transparent manner. We were also unable to determine whether the evaluation was in keeping with the information provided to the competing parties.
- 4.50 The absence of this documentation means that the DHBs might not be able to support the decision to award the contract to a particular party. They might not be able to demonstrate that the evaluation was conducted in a manner that was fair and ensured the best value for the DHB from the competing proposals.

- 4.51 Some files contained evidence of decisions made during the evaluation that did not meet our expectations of a fair and transparent process. Examples included:
- DHBs used evaluation processes that were different from those set out in the invitation documents. Evaluation criteria were altered, additional evaluation criteria were added, or weightings of criteria were amended, after the offers were opened.
 - Additional steps were added to the evaluation, such as presentations, site visits, or interviews, without a clear understanding of how these were to be included in the evaluation process.
 - The evaluation documentation indicated one party was preferred, but the contract was awarded to another party for reasons that were not documented.
 - Some parties were given an opportunity to amend their offers after the closing date for offers.

Example 25**Deviation from the planned evaluation process**

We reviewed a contract where the DHB was funding residential mental health services in the community. The contract was awarded through a competitive process.

The documentation on the file recording the evaluation process introduced new criteria into the evaluation that were not in the “Request for tender” documents. These new criteria were apparently introduced to the evaluation after the initial scoring of the tenders.

The new criteria were scored during interviews with two short-listed parties. However, the documentation was not clear how these new criteria were combined with the initial scoring to determine the final preferred provider.

Example 26**Supplier evaluated the highest not being awarded the contract**

We reviewed a contract for patient-related supplies that was a collaborative purchase by a number of DHBs. The documentation of the evaluation of submissions indicated that all participating DHBs agreed that one supplier was preferred and the contract should be awarded to that supplier.

However, the DHB we reviewed awarded a contract for these supplies to its existing supplier, who was not the same as the preferred supplier. The DHB advised us verbally that its clinicians preferred the existing supplier’s products, and that this influenced its decision. However, there was no documentation on the DHB’s files to indicate why it had chosen a different supplier, or how it had concluded that its existing supplier represented better value for money than the supplier preferred by the DHBs as a result of the collaborative purchasing process.

Example 27**Unfair opportunity to amend an offer after tender closing date**

We reviewed a contract where a DHB used a competitive purchasing approach, requesting quotes from three suppliers, to secure supplies of a relatively standard range of products.

Its existing supplier submitted a quote representing a substantial increase in its previous pricing. After all the quotes were submitted, the DHB sent a note to its existing supplier indicating that it had received cheaper quotes from their competitors, and identified that the DHB staff expressed a preference for the existing supplier's brand of product. This note went on to solicit an amended quote from the supplier to obtain a lower price. There was no evidence that any of the other suppliers were offered the opportunity to amend their quotes.

The existing supplier was awarded the contract. The documentation on the file recommending the award of the contract to the incumbent refers to a process to "negotiate" the extent of the price increase down.

Align the term of the contract with the underlying need for the supplies or services

- 4.52 In one DHB, most of the contracts we reviewed for services the DHB was funding were either contracts for one year or subject to a detailed annual review. A large proportion of these contracts were for health services that were expected to be delivered for periods much longer than a year, such as aged residential care services, mental health care services, and Māori health services. The annual contract documents were repeatedly renewed and re-issued.
- 4.53 This DHB was not alone in this practice (although it was the most notable example). In the other DHBs we visited as part of our performance audit work, more than half of the contracts we reviewed for long-term services were contracts for only one or two years. The contract files did not explain why the contract terms were so short compared to the expected duration of the services.
- 4.54 This practice creates unnecessary administrative effort, for both the DHBs and the service providers, for little observable benefit. A strategic understanding of the nature of the services under contract, and enhanced guidance and training on how to manage longer-term contracts (including options for termination clauses and ways of issuing variations for small changes) could significantly reduce the administrative workload. In doing so, the costs of administering agreements for delivering longer-term services could also be reduced.

Take particular care that contracts can be ended if needed

- 4.55 Most DHBs have some contracts that do not contain a specified end date and can be terminated only if the service provider performs poorly. Such contracts are commonly referred to as "evergreen". Most (but not all) of these contracts were inherited by DHBs from the Ministry of Health or the Health Funding Authority.

Some evergreen contracts were entered into by DHBs shortly after they were established in 2000, while others have been entered into more recently.

- 4.56 These contracts pose a risk to DHBs, particularly in circumstances where they may need to terminate the contract for reasons other than poor performance. Changes to legislation, government policy, funding availability, or service priorities might require the services to be rationalised, or funded or delivered differently. Although such changes could require an evergreen contract to be terminated, DHBs have no apparent rights to terminate the contracts for those reasons.
- 4.57 Some DHBs have modified evergreen contracts to include a provision allowing them to “terminate without cause” with six months’ notice. These new clauses remove the evergreen nature of the contracts, enabling the DHBs to recognise the long-term nature of the services while having the flexibility to respond to changing circumstances and changes in the supplier’s performance.
- 4.58 DHBs should have a structured programme of reviewing their current evergreen contracts where contractually possible. The outcome of the review should be either to put evergreen contracts on to a more conventional basis with a specified end date or to insert appropriate termination clauses.

Plan the transition from one contract to another

- 4.59 The transition from an existing supplier to a new supplier for the same supplies or services is a particular risk in procurement.
- 4.60 We noted several examples where the relationship with the existing supplier was not managed well. This led to an unwillingness on the supplier’s part to help the DHB in its transition to a new supplier. In some cases, the DHB had not done enough planning when entering the previous contract to enable it to enforce appropriate transition assistance (including the release of information about the delivery of previous services, and the transfer of patient information). In other cases, the delivery performance of the current supplier dramatically decreased during the transition, leaving the DHB without timely access to the supplies.
- 4.61 Planning for the possibility of transition to a new supplier should be included in the conscious risk management process when planning the procurement. This enables appropriate expectations to be included in the contract documents to cater for transition requirements. It also provides a basis for managing the supplier/provider relationship for the contract, including the fact that the contract may not be renewed when it expires.

Link historical supplier or provider performance with purchasing evaluation

- 4.62 DHBs purchase a large number of supplies and services on an ongoing basis. Therefore, DHBs have access to information about the past performance of a large range of suppliers and providers. However, we noted little formality in the way in which DHBs accessed and used this information during the evaluation of proposals from previous (and current) suppliers or providers for the next competitive procurement process.
- 4.63 Appropriate documentation of supplier or provider performance, and processes to access and use this information consistently during evaluations, can reduce the risk of perceptions of bias (either positive or negative) when previous suppliers are involved in new purchasing processes.

Get the supplies and services you thought you were buying

Provide better policy and guidance on contract management

- 4.64 Contract management activity occurs in an even wider range of places in DHBs than purchasing. It often consists of operational staff managing the day-to-day transactions and detailed delivery of supplies and services, as well as nominated staff managing the relationship with, and overall performance of, the suppliers or providers.
- 4.65 We have noted a general improvement in procurement policies and procedural guidance over the last three years. This is mainly in purchasing policies and procedures, with the policies and procedures for contract management not keeping pace.
- 4.66 Operational staff may not have experience in contract management. Clear guidance would enable operational staff to fully understand their contract management responsibilities. Better policies and procedural guidance would also inform these staff of the DHB's record-keeping requirements to support the decisions they make.

Plan for managing the contract when the purchase is being planned

- 4.67 Our reviews of individual contract management practices noted a general absence of formal contract management plans, even for those purchases that were very high value and/or especially important to the DHB. DHBs should be planning how they will manage the delivery of supplies when they are planning for the purchase. This is the best time to do the delivery planning because many of the

contract monitoring requirements can be incorporated in the contract terms and conditions included in the purchasing documentation.

- 4.68 We acknowledge that a lack of formal records does not necessarily mean that planning was not done or that contracts were not managed. However, the fact that risk management and the development of key performance indicators (KPIs) also need to improve indicates that DHBs could generally improve their contract management planning.

Systematically match the contract management response to the level of risk

- 4.69 Our discussions with contract management staff identified that there was often little correlation between the contract risk and the planned contract management activity to address that risk. We found that few DHBs had linked the requirements for monitoring, and the way in which monitoring would occur, with the risk of performance or delivery failure for the particular supplies and services.
- 4.70 Some DHBs have unwritten “rules of thumb” that they proactively manage only the top 10 or 20 provider arm contracts (by either volume or value). Given that many DHBs have several hundred provider arm contracts, this leaves a large number of contracts that are managed only if something goes wrong.
- 4.71 It is unclear whether this is an appropriate response to risk. It is also unclear whether DHBs are spending large amounts of time reacting to service delivery problems that could have been managed more effectively and efficiently by using a proactive approach.
- 4.72 In some DHBs, the rationale for external review of providers of services was based only on the amount of funds available and a requirement to cover all of the designated contracts in a specified period. This means that providers about whom the DHB had service delivery concerns were scheduled for review in the same way as providers for whom no concerns have been raised.

Define appropriate key performance indicators for managing performance

- 4.73 A large number of contracts that we reviewed included specific performance reporting requirements by the supplier or provider, but did not appropriately specify the standards expected by the DHB for delivering services and how those would be measured (commonly referred to as KPIs).
- 4.74 The risk of unclear service delivery performance expectations is that the DHB is unable to effectively monitor and enforce the service delivery standards it was

expecting when it purchased the supplies or services. Such standards are left open to interpretation and uncertainty.

Link financial systems and contract systems to monitor the spending on a contract

- 4.75 We noted a number of examples where contract managers did not have appropriate access to, or were not actively monitoring, the volume and value of spending against the expectations in the contract.

Example 28

Poor monitoring of actual spending against contract arrangements

In one DHB, we noted a contract in which the total amount spent in one year was 2.5 times the total value of the three-year contract. It was unclear whether this was a substantial increase in the volume of purchases made for the supplies included in the contract, or whether additional supplies were added to the contract without a formal contract variation.

In another DHB, we reviewed a contract worth \$1.2 million. The amount paid to that contracted supplier exceeded the contract value by a third. The DHB's subsequent analysis identified that the additional spending was on non-contract items. The DHB is in discussions with this supplier to formalise contract pricing and delivery arrangements for the additional product lines.

Our final example relates to a contract for which the DHB had negotiated a recovery should the amount of supplies ordered be less than the expected volume contracted for. The actual volumes ordered were consistently under the volume contracted and yet no recovery had been sought.

Know whether enough attention is being paid to procurement

Learn from reviews of contract management practices

- 4.76 Although we noted that internal audit is beginning to focus on purchasing to ensure that purchasing is conducted in keeping with policies and procedure and good practice, we found that the internal audit team was giving little attention to contract management practices.
- 4.77 If DHBs are applying effective and efficient purchasing processes, the success of the procurement still depends on managing the contract to ensure that the required supplies and services are delivered at the right quality and for the contracted prices. Contract management deserves just as much self-review attention as purchasing activity.

Appendix

Where to focus first

Procurement can be a complex area. With limitations on resources, it is important to prioritise which aspects to focus on first.

We have identified the most important improvements that district health boards (DHBs) could make to enhance the effectiveness and efficiency of procurement in contributing to the overall business of the DHB.

Recognise the significance of procurement

Procurement must be treated as fundamental to the effective and efficient delivery of services. It should be managed strategically, in proportion to its scale, and recognised as involving a significant amount of money.

This means taking a “helicopter” view of the DHB’s procurement activity and dealing with procurement strategically across the breadth of DHB activity now and for the future – both for purchasing and contract management. It also means actively considering what you want to achieve from procurement activity and setting appropriate business objectives.

To set appropriate business objectives, you need to fully understand the total extent of procurement activity throughout the DHB:

- Funding agreements with non-governmental organisations (NGOs) are procurement activity, even though the approach to purchasing services delivered by NGOs may need to be different. Consider strategically the DHB’s best procurement approach for these agreements, both the purchasing approach and the specific approach to contract management (the tools and techniques needed to manage the quality of service delivery).
- Raising a purchase order for supplies or services that are not under a contract is also procurement, even though these purchases are often relatively simple. It may be that a simple purchase order is an appropriate approach for these purchases. However, it may be that a different approach to these purchases would be more efficient.
- Clinical staff are often involved day to day in raising purchase orders or managing the delivery of a contract. They are therefore involved in procurement.

Consider these issues from your “helicopter” view, and determine an appropriate approach based on a full understanding of how each purchase fits the bigger picture.

Clarify how much risk the DHB is prepared to take (its strategic risk appetite) in procurement matters, and use this guidance to apply the appropriate levels of effort in purchasing and contract management processes.

Allocate adequate resources to the task of procurement. Ensure that you have appropriate information systems to collect and collate information to report on procurement matters, and involve procurement in strategic and business planning.

Recognise that procurement needs to involve an understanding of the business. Therefore, procurement staff need to work with staff involved in service delivery to ensure that procurement staff are purchasing supplies and services fit for their purposes.

Support procurement activity

Invest in procurement staff and their continuing development. They are a DHB's best response to procurement risk, but they need to be kept up to date with developments if they are to contribute their best. They will gain exposure to new initiatives that may deliver better results than current practices. Continuing professional development also works to develop the pool of procurement talent and experience, reducing the risks of turnover of experienced staff.

Share good practice and new ideas within the DHB and with other DHBs. If a new procurement initiative works well once in one DHB, it may well work for others. If the information is shared between DHBs, they may also share information about what worked well for them. All DHBs can potentially save time and effort from avoiding the need to "reinvent the wheel".

Make procurement easier

Develop information systems to provide procurement information for management. Although many DHBs are improving their management information about purchasing and contract management activities, there is much that can still be done to improve, both in terms of the technology systems to support data gathering and in the analysis of the data to produce information useful to senior management and the Board.

Prepare better guidance for staff on procurement practice expectations. Standardise processes and documents for tailoring to individual circumstances and provide appropriate guidance about tailoring for scale and risk.

Manage risk

Raise the profile of risk management throughout the procurement process, both in terms of purchase risks and risks with managing the delivery of the supplies and services. Consider the possibility of providing a generic risk assessment or a risk assessment workshop to assist those unfamiliar with risk management.

Manage “pockets” of procurement activity according to business needs and risks. Smaller pockets of procurement may need support, but do not need to be overwhelmed by overly complicated processes. Understand the business needs and risks, and tailor the procurement approach to suit. Develop delegations and purchasing thresholds to suit the business needs and risks.

Manage risks consciously. Sometimes, DHBs are unwittingly accepting procurement risks because they have failed to consider all risks in a systematic way. Actively consider the risks associated with procurement and the responses required to reduce or manage those risks, particularly the risks around the underlying principles of openness, fairness, and value for money.

Consider risk early in the procurement process – more considered thought during planning generally leads to more considered responses to risks appropriate to the likelihood and consequence of the risk event occurring. Document the risk response and monitor whether it has the desired result. Amend the response if it does not. Consider new risks that may arise during the procurement process. Effective risk management is ongoing.

Keep the end objective of the procurement in mind at all times – do not let the process drive the decisions, but make the decisions drive the process).

Monitor performance

Monitor procurement activity in proportion to its scale – give it the attention that an activity representing between 36% and 70% of total spending deserves.

Review procurement activity regularly for compliance with policy and procedure. Review the adequacy of risk management consideration and response.

Report the results of this review activity and the results of the procurement activity (including the measurement of achievement against the business objectives) to senior management, the Audit Committee, and/or the appointed or elected members of the Board (as appropriate).

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Other publications issued by the Auditor-General recently have been:

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- Inquiry into the Plumbers, Gasfitters, and Drainlayers Board
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- Inquiry into New Zealand Defence Force payments to officers seconded to the United Nations
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- Local government: Results of the 2008/09 audits
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