

NATIONAL TREASURY
Republic of South Africa
September 2003



**POLICY STRATEGY TO GUIDE UNIFORMITY IN
PROCUREMENT REFORM PROCESSES IN
GOVERNMENT**

EXECUTIVE SUMMARY

1. OBJECTIVES

This policy strategy intends to achieve the following high level objectives:

- Promoting uniformity in the processes relevant to the repealing of tender board legislation in the various spheres of government and devolving the responsibility and accountability for procurement-related functions to accounting officers/authorities.
- Promoting uniformity in the various spheres of government in the interpretation of government's preferential procurement legislation and policies, also in the context of other broad-based but related legislative and policy requirements of government.
- Replacing the outdated procurement and provisioning practices in government with a supply chain management function and a systematic competitive procedure for the appointment of consultants as an integral part of financial management in government that conforms to internationally accepted best practice principles.
- Introducing parameters for the promulgation of a regulatory framework in terms of the PFMA and MFMA to ensure compliance to minimum norms and standards; but in such a manner that the principles of co-operative governance are observed.

2. BACKGROUND

Procurement reforms in government started in 1995 and were directed at two broad focus areas, namely the promotion of principles of good governance and the introduction of a preference system to address certain socio-economic objectives. The procurement reform processes were supported by the introduction of a number of legislative measures, including the adoption of the PFMA and the PPPFA.

The procurement reform initiatives were given further impetus when in November 2000, the "Report on Opportunities for reform of Government Procurement in South Africa served before Cabinet. Cabinet endorsed the

thrust of the report and directed that the Minister of Finance, in consultation with other relevant Ministers, address the details where necessary.

As the procurement reform measures in the national sphere of government were replicated by the other organs of state, very divergent interpretations of government's procurement objectives and strategies became prevalent. To assist the National Treasury in guiding a more uniform implementation approach, a Joint Country Procurement Assessment Review (CPAR) was conducted during 2001/02 with the World Bank. The CPAR revealed a number of deficiencies that needed to be addressed. These deficiencies are summarized below under issues that relate to governance aspects and aspects that relate to the interpretation and implementation of the PPPFA and its associated regulations.

2.1 Governance issues

- The need to issue a single national legislative framework in terms of section 76(4)(c) of the PFMA and 106(1)(d) of the MFMA to guide uniformity in procurement reform initiatives in the different spheres of government.
- The need to replace the outdated and inefficient procurement and provisioning practices in government with a supply chain management function and a systematic competitive system for the appointment of consultants that are fully integrated with the financial management processes in government and that conform to internationally accepted best practices.
- The need to prescribe minimum norms and standards to promote uniformity in bid documentation, advertising, receipt and adjudication procedures.
- The need to monitor value for money performance.

2.2 Issues relevant to the implementation of the PPPFA and its associated regulations

- The PPPFA and its supporting regulations are complex and therefore difficult to implement correctly.

- Preferential procurement policies are not clearly formulated and targets are not set for the introduction of sunset and graduation provisions once targets had been achieved.
- Procurement practitioners are not adequately trained in the application of the PPPFA and its associated regulations.
- The costs and outcomes of the PPPFA are not assessed adequately to evaluate the merits of the system.
- There is inadequate provision for capacity building for disadvantaged enterprises to successfully compete for government contracts.
- Certain organs of state apply set-aside practices, instead of the prescribed preference points system.
- Certain departmental policy directives are in conflict with the provisions of the PPPFA.

This policy strategy intends to address the above aspects by means of appropriate interventions by the responsible authorities in the various spheres of government. In addressing these matters, uniformity in supply chain management practices and procedures will be promoted in a spirit of co-operative governance.

3. Policy Interventions

The following policy interventions are necessary:

3.1 Introducing an integrated supply chain management function:

The introduction of an integrated supply chain management function intends to address the division between the current outdated procurement and provisioning processes in government that cause the present system to be inefficient in its method of procurement, contract management, inventory/asset control and obsolescence planning.

Supply chain management is an integral part of financial management that seeks to introduce internationally accepted best practice principles, whilst at the same time addressing government's preferential procurement policy objectives.

The integrated supply chain management process, where value is added at every stage of the process, is depicted in the diagram on page 20 of this policy strategy document. The process will link to government's budgetary planning processes, but will also strongly focus on the outcomes of actual expenditure in respect of the sourcing of goods and services.

3.2 Introducing a systematic competitive procedure for the appointment of consultants

It is necessary that certain minimum requirements of quality and efficiency be achieved when appointing consultants. It is also necessary to ensure that advice that is being solicited is unbiased, that is, being delivered by a consultant/s acting independently from any affiliation, economic or otherwise, which may cause conflicts between the consultant's interests and those of government.

It is also necessary to impose measures to ensure that assignments to consultants are executed in such a way that the ethical principles of the relevant consultancy profession are met at all times.

3.3 Introducing a national legislative framework to enforce minimum norms and standards and uniformity in respect of supply chain management practices and the interpretation of policy objectives:

The promulgation of a regulatory framework in terms of section 76(4)(c) of the PFMA and section 106(1)(d) of the MFMA when the latter Act is finally promulgated will establish the policy parameters for the repealing of the existing tender board legislation and will prescribe minimum norms and standards for supply chain management practices in government.

The regulatory framework will further empower the National Treasury to facilitate the arranging of certain transversally used term contracts in instances where it might be more beneficial from a value for money perspective and/or in achieving government's preferential procurement policy objectives. The regulatory framework will also establish minimum reporting

requirements for accounting officers/authorities which will empower the National Treasury to monitor compliance to minimum norms and standards and policy outcomes so as to regularly report progress to Cabinet.

Uniformity in supply chain management practices would amongst others be promoted through uniformity in bid and contract documentation and options and standards of bid policies and procedures.

The National Treasury will issue a limited number of practice notes in terms of the framework to guide uniformity in practices and procedures in the different spheres of government, whilst provincial treasurers and municipal managers will issue further practice notes in a cascading fashion to guide the more detailed implementation of supply chain management functions.

In more fully addressing the deficiencies associated with the current PPPFA and its associated regulations, it is recognised that amendments to the Act and regulations would be necessary, particularly in respect of the need to more effectively achieve government's BEE policy objectives. This aspect will be addressed as an integral part of the process associated with the promulgation of the Broad Based Black Economic Empowerment Bill and implementing the principles and philosophies contained in its supporting strategy document during the course of 2003.

4. IMPLEMENTATION STRATEGY

The very substantial divide between the current outdated procurement and provisioning practices in government and the new integrated supply chain management function necessitates a phased implementation approach.

To prepare departments for the new concepts, tender boards, in liaison with the relevant treasuries, should begin to significantly delegate their authority to procurement departments so that the latter can begin to build capacity. In this endeavour, accounting officers/authorities should be supported by their relevant treasuries.

Capacity building would include the establishment of supply chain management units in the relevant CFO structures, the establishment of clear

lines of authority and accountability and performance criteria for the minimising of risk, quicker and more efficient sourcing and better asset and inventory management.

It is the responsibility of every accounting officer/authority to ensure that their supply chain management personnel are adequately trained. The National Treasury is in the process of facilitating the development of appropriate training material in conjunction with SAMDI, IPFA and other service providers to assist accounting officers/authorities in the training of their personnel.

The policy strategy document and its supporting regulatory frameworks will initially apply to all national and provincial departments, constitutional institutions, public entities as defined in Schedule 3A and 3C of the PFMA, municipalities and municipal entities defined in the MFMA and all school governing bodies.

The policy strategy will be adapted to also include appropriate directives that will be applicable to public entities as defined in schedule 2 of the PFMA, after the amendment of the PPPFA and its associated regulations. The latter Act and its regulations will be aligned with the provisions of the Broad Based Black Economic Empowerment Bill and its supporting Strategy document during 2003, in such a way that preferential procurement targets will be set and incorporated into policy charters that will be issued by the Minister of Trade and Industry. These policy charters and the associated targets will also be applicable to schedule 2 public entities.

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PART 1

1. INTRODUCTION

1.1. Background

At the outset of the procurement reform process in 1995, it was recognised that a consistent legislative framework would be required to give effect to government's procurement reform policy objectives. As an interim measure, it was recognised that procurement reforms would have to be limited to those measures that could be implemented within the ambit of existing legislation. A 10 Point (Interim Strategies) Plan was adopted during November 1995. The 10 points of this plan encompassed 10 strategies designed to impact positively on the participation in the bidding system of small, medium and micro enterprises, with emphasis on the disadvantaged and marginalised sectors and with a focus on employment creation.

A Green Paper on Public Sector Procurement Reform in South Africa was published in April 1997. The Green Paper recognised that public sector procurement could be used by government as a mechanism to also achieve certain broader policy objectives such as black economic empowerment, local economic development spin-offs for small and medium sized business, skills transfer and job creation. To achieve this, institutional and economic reform was necessary within two broad themes, namely, to establish principles of good governance in the area of supply chain management and to introduce a preference system to achieve certain socio-economic policy objectives.

During November 2000 a memorandum served before Cabinet to propose certain changes to the procurement system in government. This Cabinet memorandum was supported by the "Report on Opportunities for reform of Government Procurement in South Africa" – the Roger Webb report.

Cabinet endorsed the thrust of the report and directed that the Minister of Finance, in consultation with other relevant Ministers, address the details where necessary.

Provinces also replicated the procurement reform initiatives. However, very divergent interpretations of government's procurement objectives and strategies became prevalent.

To assist the National Treasury in adopting a more uniform implementation approach, the National Treasury conducted a Joint Country Procurement Assessment Review (CPAR) with the World Bank during 2001/02.

The CPAR identified a number of issues that needed to be resolved. These issues could be classified into two main categories: firstly issues that require attention from a governance perspective and secondly, issues that relate to problems experienced in respect of the implementation of the PPPFA and its supporting regulations.

1.1.1 Governance issues

The following is a summary of the main aspects that needed to be resolved to improve governance in the procurement and provisioning systems of government:

- Serious conflicts of interest are prevalent due to the constitution of bid adjudication bodies. Following the Cabinet decision of November 2000, provinces initiated their processes to review their tender board legislation. The new legislation did however not in all instances address the potential conflict of interests caused by the constitution of the new tender adjudication bodies.
- The procurement and provisioning procedures in government are overly rule driven, where value for money is almost always equated to the lowest price tendered. The emphasis is almost exclusively focused on the monitoring of inputs, with little or no regard to the outcomes of procurement and provisioning processes.
- Procurement and provisioning activities are executed almost as stand-alone processes, where there is little or no linkage to budgetary planning. The current cash-based accounting in government encourages poor asset management practices, where asset management is focused mostly on

an inventory control approach, rather than on the concept of a satisfactory financial and developmental return that needs to be realized on the capital that is invested in goods, services and inventories/assets. This aspect is also being addressed in a broader context through the implementation of the PFMA.

- There is a lack of uniformity in bid documentation, advertising, receipt and adjudication procedures. This causes uncertainty and inefficiencies, not only on the part of bidders, but also within government.
- Data on contract awards and completion is not collected systematically throughout government. This makes it difficult to monitor value for money performance.
- Consultants are not selected in a systematic and competitive manner, despite the very substantial amounts expended annually by government to engage the services of consultants.

1.1.2 Issues relevant to the implementation of the PPPFA and its associated regulations

The following is a summary of the issues that were related to the implementation of the PPPFA and its associated Regulations:

- The PPPFA and its associated regulations are complex and therefore difficult to implement correctly. The PPPF Act and Regulations prescribe a definition of HDIs that should be used in granting preference points in the awarding of contracts. The definition includes, but is not exclusive to the promotion of BEE. This causes great confusion and in certain instances a total disregard of the definition in the PPPFA and its associated Regulations. A second set of problems in applying the definition arises from the fact that the definition is circumvented by way of large scale fronting practices that take place. The situation is aggravated by the fact that the PPPFA policies were not properly formulated and that national targets were not set in respect of important policy objectives such as the promotion of HDIs and SMMEs. This problem is further aggravated by the fact that procurement practitioners are not adequately trained in the

application of the PPPFA and its associated regulations. (It is estimated that there are about 15000 officials directly and indirectly involved in the procurement and provisioning area throughout government.)

- The costs and outcomes of the PPPFA are not assessed adequately to evaluate the merits of the system. This is mainly due to the lack of a systematic and consistent collection of data throughout government.
- There is inadequate provision for capacity building for disadvantaged enterprises to successfully compete for government contracts, despite the fact that the 80/20 and 90/10 points system as prescribed in the PPPFA provide for the payment of a premium of 25 percent in respect of contracts of R500 000 and below and 11.1 percent in respect of contracts above R500 000, for the awarding of contracts to disadvantaged enterprises.
- In addition to the incorrect application of the PPPFA and its associated Regulations in certain cases where set-aside practices are prevalent instead of applying the prescribed preference points system, certain departmental policy directives are also in direct conflict with the provisions of the PPPFA.

During March 2003 Cabinet adopted a Strategy On Black Empowerment and also The Broad Based Black Economic Empowerment Bill, 2003. The Strategy Document and Bill were advertised for public comment with a view of promulgating the Bill during 2003.

The Strategy Document also highlights the problems that are experienced with the implementation with the PPPFA and its associated Regulations and proposed a framework for the review of the Act and regulations.

This policy document proposes a framework for certain more immediate policy interventions that aim to correct the governance deficiencies associated with supply chain management practices and also to enhance uniformity in the interpretation of government's preferential procurement policies.

The PPPFA and its associated Regulations will be reviewed during the course of 2003 as an integral part of the process to promulgate the Broad Based Black Economic Empowerment Bill, 2003.

Accounting officers/authorities would however be required to continue to implement the current PPPFA and its Associated Regulations until such time that the Act and Regulations are formally amended.

1.2 Legislative Environment

This Policy Strategy is provided against the background of the provisions of the Constitution and subsequent enabling legislation and the promulgation of new BEE legislation and amendments to the PPPFA as contemplated by government.

1.2.1 Constitutional Provisions

Section 217(1) of The Constitution of the Republic of South Africa, 1996 (Act 108 of 1996) (The Constitution) provides the basis for procurement and determines that:

“When an organ of state in the national, provincial or local sphere of government, or any other institution identified in national legislation, contracts for goods or services, it must do so in accordance with a system which is fair, equitable, transparent, competitive and cost-effective”.

Section 217(3) of The Constitution, 1996 further confers an obligation for national legislation to prescribe a framework providing for preferential procurement to address the social and economic imbalances of the past.

1.2.2 Enabling Legislation for a preferential procurement system

The Preferential Procurement Policy Framework Act, 2000 (Act 5 of 2000) and its accompanying Regulations were promulgated to prescribe a framework for a preferential procurement system. This Act and its Regulations incorporate the 80/20 and 90/10 preference point systems.

Sections 215-219 of The Constitution, 1996 further require that the National Treasury introduce uniform norms and standards within government, to ensure transparency and expenditure control measures, which should include best practices related to procurement and provisioning systems.

1.2.3 Financial enabling Legislation

The Public Finance Management Act, 1999 (Act 1 of 1999 as amended by Act 29 of 1999) (PFMA) was promulgated to regulate financial management in the national and provincial spheres of government. The Municipal Finance Management Bill (MFMA) of 2002 will extend the same principles to municipalities. It is the responsibility of the National Treasury to foster coherent financial management in all organs of state, across all three spheres of government. At the same time considerable powers are assigned to accounting officers, accounting authorities and municipal managers to enable them to manage their financial affairs within the parameters laid down by the prescribed norms and standards. Both the PFMA and the MFMA require National Treasury to monitor the compliance of these prescribed norms and standards.

This policy document determines the underlying support structure that sets the parameters for the execution of supply chain management within government; and aim to formulate and consolidate supply chain management policies in all spheres of government and for all organs of state as outlined in paragraph 1.3 below.

- The onus of responsibility for supply chain management is placed on the accounting officers/authorities and municipal managers, thereby giving effect to section 38(1)(a)(iii) of the PFMA and section 36(a) of the MFMA. The Supply Chain Management Policy is strengthened by the issuing by the National Treasury of a framework as contemplated in terms of section 76(4)(c) of the PFMA and 106(1)(d) of the MFMA. This framework will determine specific norms and standards for supply chain management.
- To make all this possible and ensure uniformity in legislation, it would be necessary for both the national and provincial legislatures to repeal the respective Tender Board Acts.
- This Policy Strategy and the subsequent framework to be issued in terms of section 106(1)(d) of the MFMA would also replace regulations regarding the calling of tenders at municipal level as issued in terms of the Local Government Transition Act (as amended) by the Minister for Provincial Affairs and Constitutional Development published in Government Gazette No R.1224 dated 2 October 1998 and its amendments as published in No. R.387 dated 26 March 1999 (refer to Local Government Transition Act (as amended) and Municipalities in particular.

1.3 Scope of application of the supply chain management policy

The Policy Strategy will apply to the acquiring and disposing of all goods, services, construction and road works and immovable property of all constitutional institutions, public entities as defined in schedule 3A and 3C of the PFMA, national and provincial departments, trading entities, municipalities and municipal entities as defined in the MFMA and all school governing bodies whether or not they have been assigned additional responsibilities in terms of section 21 of the South African Schools Act, 1996.

The successful implementation of this Policy Strategy is dependent on the principles of co-operative governance and intergovernmental relations as worded in sections 40 and 41 of the Constitution, enshrining the autonomy of each sphere whilst regulating the relationship between those spheres. This

concept is carried consistently throughout the Constitution particularly in sections 139 and 146.

1.4 Objectives of supply chain management policy

The objectives of this Policy are:

- To give effect to the provisions of The Constitution, 1996;
- To give effect to the provisions of the PFMA and the MFMA;
- To transform the procurement and provisioning functions in government into an integrated supply chain management function;
- To introduce a system for the appointment of consultants;
- To create a common understanding and interpretation of government's preferential procurement policy objectives; and
- To promote consistency in respect of supply chain policy and other related policy initiatives in government.

1.5 Definitions and interpretations

- Accounting Officers: As defined in section 36 of the PFMA, and includes for ease of use throughout this document also municipal managers as defined in the MFMA.
- Accounting Authority: As defined in section 49 of the PFMA and section 58 of the MFMA.

PART 2

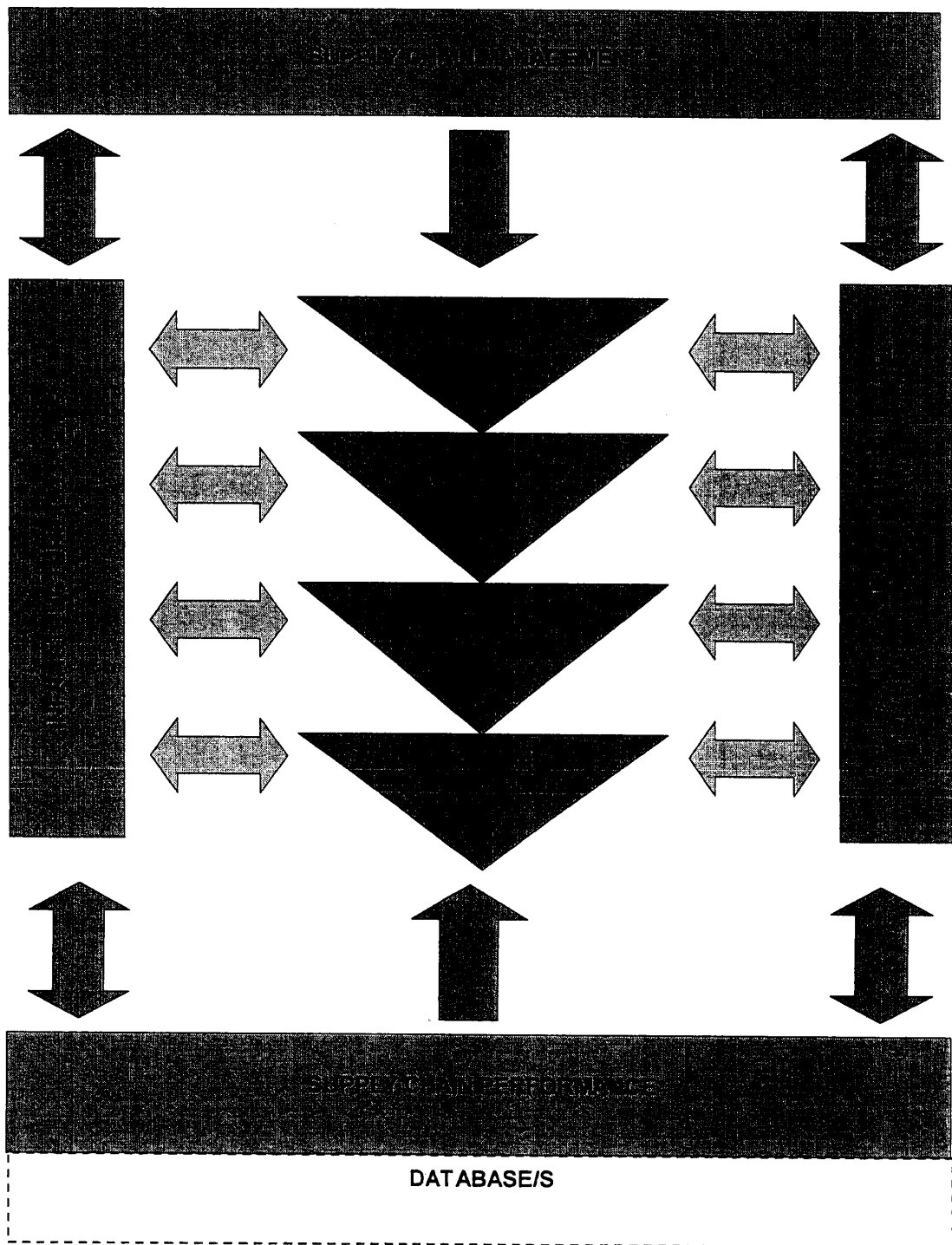
2. INTRODUCING THE CONCEPT OF SUPPLY CHAIN MANAGEMENT

2.1 Supply Chain Management

Supply chain management is an integral part of financial management, which intends to introduce international best practice. It seeks to breach the gap between traditional methods of procuring goods and services and the balance of the supply chain and at the same time addressing procurement related matters that are of strategic importance.

The introduction of the principles of supply chain management will require of accounting officers and accounting authorities to extract accurate commercial and other relevant information, so as to effectively measure the achievement of government's procurement objectives.

The elements of government's supply chain management processes are depicted in the diagram below, where value is added at each phase of the process.



Current work in the National Treasury includes the development of a systems master plan for an integrated financial management system that conforms to

the requirements of the PFMA. This master plan will include the systems requirements, including the requirements of E-commerce, to more fully support the adoption of the proposed integrated supply chain management function.

Accounting officers/authorities are therefore required not to acquire new information technology support for the implementation of the new supply chain management function without consulting the National Treasury.

2.1.1 Demand Management

This is the beginning of the supply chain where the following functions should take place:

Determining a needs assessment dealing with issues such as:

- Understanding future needs;
- Identifying critical delivery dates;
- The frequency of need;
- Linking the requirement to the budget;
- Doing an expenditure analysis (based on past expenditures);
- Determining the specifications;
- Doing a commodity analysis (checking for alternatives); and
- Doing an industry analysis.

This is a cross-functional exercise that brings the supply chain practitioner closer to the end user and ensuring that value for money is achieved.

2.1.2 Acquisition Management

This is the stage where:

- The preferential procurement policy objectives are identified that could be met through the specific contract;
- The strategy of how the market is to be approached is determined;
- Applicable depreciation rates are determined;
- The total cost of ownership (TCO) principle is being applied e.g.
 - Life cycle cost;
 - Inventory carrying cost;
- The bid document would be compiled, attaching all necessary required documents and giving conditions etc;
- The bid evaluation criteria is determined;
- Bids would be evaluated and recommendations tabled;
- Contract documents would be compiled and signed;

- Contract administration is done; and
- Contract information is used to kick-start the logistics management process.

2.1.3 Logistics Management

For stock or inventory items the following functions will amongst others be performed:

- Coding of items;
- Setting of inventory levels;
- Placing of orders;
- Receiving and distribution of material;
- Stores/Warehouse management;
- Expediting orders;
- Transport management; and
- Vendor performance etc.

For fixed capital items (construction and road projects, immovable property) a similar process, *mutates mutandis* has to be adopted, i.e. appropriate classification, additions to asset and property register, valuation, main use, etc.

From this process the financial system is activated to generate payments.

2.1.4 Disposal Management

At this stage:

- Obsolescence planning or depreciation rates per item required to be calculated;
- A data base of all redundant material is kept;
- Material is inspected for potential re-use;
- A strategy is determined of how the items are going to be disposed of; and
- Executing the physical disposal process.

Again a similar set of procedures is applicable to fixed capital stock, i.e. depreciation, maintenance and replacement planning and costing, etc.

2.1.5 Supply Chain Performance

Here a monitoring process takes place, undertaking a retrospective analysis to determine whether the proper process is being followed and whether the desired objectives are achieved.

Some of the issues that may be reviewed are:

- Achievement of goals;
- Compliance to norms and standards;
- Savings generated;
- Stores efficiency;
- Cost variance per item;
- Contract breach etc;
- Cost efficiency of procurement process (i.e. the cost of the process itself);
- Whether supply chain objectives are consistent with government's broader policy focus – also refer to paragraph 3.7 of this Policy document;
- That the material construction standards become increasingly aligned with those standards that support international best practice;

- That the principles of co-operative governance as expounded in the Constitution are observed; and
- That the reduction of regional economic disparities are promoted.

